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THE TREASURY
Kaitohutohu Kaupapa Rawa

Investment Statement:

Managing the Crown's Balance Sheet

26 March 2014

ISBN: 978-0-478-42141-5 (print) 978-0-478-42142-2 (online)

Acknowledgements

The Treasury would like to acknowledge agencies' contributions to the performance information detailed in Chapter 4 of this document, and the comments provided by an external panel of experts on the development of this Statement.

Preface

The 2014 Investment Statement fulfils a fiscal reporting requirement set by Parliament when it amended the *Public Finance Act 1989* late last year.

It provides information on the shape and health of the Crown's portfolio of assets and liabilities at the end of the last full financial year. It outlines how the balance sheet has changed in recent years and it includes forecasts on its anticipated composition and size through to 30 June 2018.

Individual agencies' non-financial asset management performance information cited in this Statement was collated in 2013 and early 2014.

Based on the information available, this Statement provides a general assessment of how closely the Crown's balance sheet composition aligns with governments' service delivery objectives. It assesses where the main risks lie in terms of governments' ongoing ability to provide the public goods and services that New Zealanders expect of their governments.

Owning the right assets, managing them well, funding them sustainably, and managing risks to the Crown balance sheet are all critical to the provision of high-quality and cost-effective public services. That means that the quality of balance sheet management is vital to maintaining New Zealanders' living standards now and in the future.

Yet one of the key findings of this Statement is that the information available to assess whether Crown assets are fit for purpose and being cost-effectively managed is not as consistently strong as it should or could be across the public sector.

That is why creating systems for better information collection and evaluation will be a priority for the Treasury in its work with agencies in the years ahead. The next Investment Statement, required to be presented to Parliament no later than four years from now, will outline progress made on the areas of focus identified in this Statement and highlighted in the Executive Summary.

In preparing this Statement, the Treasury has used its best professional judgement.

Gabriel Makhlouf
Secretary to the Treasury
20 March 2014

Contents

Executive Summary

The 2014 Investment Statement is the first to be produced by the Treasury since the recent amendments to the *Public Finance Act 1989*. It examines the composition and state of the Crown balance sheet – what the government owns and owes – and discusses the principles of efficient balance sheet management. It builds on the existing suite of government publications designed to bring transparency and accountability to the public sector.

New Zealand has long been recognised as a world leader in public sector management, and this extends to management of its balance sheet. In recent years there has been a growing emphasis on Crown balance sheet management resulting in better practice, but there is still room for improvement. The major conclusions of the Statement, and areas identified as requiring further work, analysis or improved management, are summarised in this Executive Summary.

Effective balance sheet management underpins living standards

Every year New Zealanders make a significant contribution to support government activities through the taxes and levies that they pay. Last year tax receipts were around $58 billion. In addition the core Crown borrowed around $14 billion through the issuance of Government bonds – this, plus interest, must be repaid by future taxpayer contributions. A significant portion of these funds go to supporting the Crown's balance sheet.

With over $240 billion in assets, $170 billion in liabilities and $70 billion in equity, the Crown's balance sheet is large – assets alone are worth more than a full year of total output from the economy. That means many families' indirect share of the Crown's assets and liabilities would typically be second only in value to the family house and mortgage.

The size of the balance sheet reflects the growth in the role of government over time. The balance sheet has changed significantly in the last 20 years and will continue to change in the future. It will grow as the economy grows and, in particular, as holdings of financial assets increase as a result of governments' efforts to partly prefund the future costs of superannuation. Those assets will form a relatively greater proportion of the Crown's portfolio of assets over time. The Crown's contingent and implicit liabilities will also grow with time. Recent events have shown the effect these can have on the Crown balance sheet.

The implications of these changes will require ever more astute management. Flexibility will need to be maintained to ensure the balance sheet remains fit for purpose and risk management issues will need greater attention than in the past.

It is this outlook that makes it increasingly important to ensure that the balance sheet underpins living standards for New Zealanders. This is about value for money. More efficient balance sheet management would open opportunities for governments to either spend more on raising the quality and quantity of services – such as education and healthcare – or alternatively to lower the Crown's tax take, which would mean more money in taxpayers' pockets.

Strong balance sheet management, with the use of performance targets, can also complement efforts to raise the economy's productive performance. This can be done through promoting macroeconomic stability by helping to manage risks to the wider economy, and by increasing the availability of resources to the private sector by using assets more productively. It also allows governments to achieve an equitable distribution of benefits, costs, and risks across current and future generations and helps with the management of looming long-term fiscal challenges due to population ageing and demographic change.

Area of focus:

- Governments should consider the use of specific performance targets in meeting the requirements under the *Public Finance Act* to outline a strategy for managing the Crown's capital and balance sheet.

Governments need to be efficient and effective in the use of resources

Governments have limited resources with which to deliver on their objectives. The capital employed in asset ownership is never free and assets need to provide benefits greater than the inherent costs of ownership.

Governments need to clearly identify the outcomes sought, and subject investment alternatives and delivery mechanisms to rigorous evidenced-based evaluation of costs, benefits and risks.

Public ownership needs to be assessed against its ability to deliver on outcomes and value for money, and should not be seen as the default setting. Different interventions have led to very different balance sheet outcomes. Governments have used different methods to advance public policy objectives over the years. For example, while a majority of schools are owned by the Crown, early childcare education has a large element of publicly funded private provision.

Ineffective management of assets and liabilities has real costs to New Zealanders. Poor investment decision making not only reduces the resources available to fund priorities directly, but also can result in unnecessary additional operating expenditure.

Changes to society and demographics will occur in the future. Flexibility in balance sheet management is needed to ensure that as circumstances change, the composition of the balance sheet remains appropriate and value for money is still assured.

While there has been a significant improvement in balance sheet management practices in recent years, the information collected for this Statement suggests that these practices are still not as good as they should be across the public sector. Significant Crown investment occurs without being subject to a formal process that ensures it aligns with overall government priorities. That means while individual agencies may be making investment decisions that reflect their own priorities, assets may be better deployed to reflect governments' long-term priorities.

The analysis in this Statement suggests there may be a case for greater coordination in asset performance and investment decision making, and stronger settings in the form of guidance, direction, or monitoring to sharpen incentives and improve balance sheet management practice. In some cases it may be necessary to review decision making arrangements to facilitate more coordinated cross-sector capital investment to better align agency priorities with governments' long-term priorities.

Areas of focus:

- Ensure settings bring about more rigorous capital investment decision making and support asset management practice to improve alignment between investment and governments' long-term priorities.

- Explore how capital could be recycled to meet changing demands and priorities without incurring unnecessary costs.

More systematic collection and use of information is necessary

New Zealand is a leader in fiscal transparency and financial reporting and has well-developed systems to support this. However, the Crown's understanding of non-financial performance and risk information could be improved.

Better information is needed to support decision making that takes into account the Crown's aggregate balance sheet position. High quality information is vital to implementing more rigorous investment decision making and balance sheet management from a whole of Crown perspective.

This Statement has attempted to collate a significant amount of information. This process was challenging and ad hoc, as the Crown currently does not have the systems and processes in place to capture the information needed in a robust manner.

Area of focus:

- Develop a structured, systematic and robust mechanism for the collection of better information required to support more rigorous investment decision making and deliver on actions discussed in this document.

The balance between devolution and coordination

A theme of this Statement is the balance between fostering accountability for agency performance through a devolved operating model, and the need for greater agency coordination and understanding of the impacts of discrete decisions in aggregate.

This Statement outlines a number of areas where balance sheet management could improve. There may be a need for greater central understanding of Crown assets, for more coordinated investment decision making, and for a more efficient and well understood financial risk management system. To improve outcomes the balance between devolution and coordination might need to be adjusted through greater use of central capabilities.

This would be consistent with recent developments. Parliament's decision to amend the *Public Finance Act* and the *State Sector Act 1988* was designed to facilitate greater coordination between agencies to work collaboratively towards achieving government outcomes.

Greater coordination is being introduced on an issue by issue basis, where it makes sense to support chief executives or to get the best outcome for New Zealanders. For instance, this greater coordination is being applied through the pursuit of the Better Public Services Key Results, and the use of functional leads in areas of procurement, property and ICT.

Decisions on the proposed steps towards coordination to improve balance sheet management should draw on lessons from other changes and an understanding of the impact on the whole operating model.

Area of focus:

- Assess whether further system level capability can adjust the balance between accountability and coordination to achieve better outcomes.

Owning the right assets: performance challenges and opportunities

This Statement represents a comprehensive assessment of the utilisation of Crown assets and their effectiveness in meeting public policy objectives. The focus of this analysis was Crown property, plant and equipment. This includes the bulk of the physical assets governments use to deliver social outcomes.

There is evidence that in many areas these assets are ageing, not well maintained, underutilised or no longer fit for modern purposes. For example, many schools, courts, and social houses are over 40 years old, which can have implications for ongoing operating costs or may soon require material replacement capital. In addition, there may be significant misalignment of capacity in large parts of the social sector. This may reflect the implications of demographic changes since these assets were built.

Measuring and monitoring the contributions of assets and new investment to outcomes must improve, and better performance measures need to be developed across the whole of government. Without that, there could continue to be asset underutilisation, misalignment with needs, and age-related functionality and cost problems.

Area of focus:

- Further develop and utilise metrics for the measurement and monitoring of the performance of Crown assets in meeting government objectives.

Managing risk: understanding the financial implications of aggregate risk

Risk affects governments' ability to deliver on their objectives cost effectively. Effective financial risk management underpins living standards by increasing the Crown's resilience to shocks. This maximises the benefits and minimises the costs of publicly provided goods and services, and improves economic growth and social outcomes.

Beyond the financial risks it faces on its own balance sheet, the Crown plays a vital role in bearing risk on behalf of New Zealanders. These risks are some of the largest the Crown faces. Implicit and contingent financial liabilities require careful management to ensure they do not have unintended negative fiscal, economic or social consequences.

The Crown's current financial risk management framework generally involves holding agencies responsible for the risks that they individually face, subject to some central guidance, and with coordination for risks with broader national implications. Resilience is supported through low debt levels and a strong balance sheet.

This model works well although it may be less efficient and effective than it could be – more coordinated financial risk management may improve this. There is a need to have a better aggregate view of Crown financial risk to ensure that total risk is consistent with governments' risk appetites.

The financial risk implications of a larger balance sheet, more heavily weighted to financial assets, will need careful consideration in the future.

Areas of focus:

- Build a fuller understanding of aggregate Crown financial risk.
- Investigate whether efficiencies can be achieved within the current financial risk management framework.
- Continue to develop policy to manage the Crown's contingent and implicit liabilities to help ensure economic stability, fiscal resilience and social outcomes are maintained.

Fiscal sustainability: building buffers and liability management

The Crown needs to maintain an adequate fiscal buffer that can sustain government activities in the event of a major shock. The worth of this approach was clearly demonstrated by the global financial crisis and the Canterbury earthquakes. Repaying the core Crown debt raised to deal with these two events should have a high priority as surpluses eventuate.

Once prudent core Crown debt levels are reached the Crown could look to fund future obligations and contingencies through further saving. This would help the Crown cope with the fiscal implications of projected demographic pressures. Saving has social implications as costs are borne by the same generation that receive the benefits of interventions.

Many of the liquid assets owned by the Crown are not available in the event of a severe shock. There might be merit in having access to a general pool of assets to augment the Crown's fiscal buffers against a range of contingencies.

Areas of focus:

- Investigate whether improvements could be made to the Crown's current arrangements for contingency funds and reserves.
- Continue the focus on strengthening the Crown's balance sheet buffers in a timely way to further improve resilience.

Part 1: Introduction to the Balance Sheet

This section discusses the purpose of the 2014 Investment Statement (hereafter referred to as either the Statement or the Investment Statement), including its contribution to New Zealand's fiscal transparency. It examines the importance of the balance sheet, and its management, to supporting the public policy priorities of governments. In particular, it discusses the importance of efficiency and effectiveness in providing the right services and value for money for taxpayers, and the balance sheet's role in supporting macro-economic stability and economic performance.

Chapter 1: Introduction

The *Public Finance Act 1989 (PFA)* sets out the requirements of this fiscal accountability document. These are to describe and value the Crown's assets and liabilities and to outline how they have changed, and will change, over time.[1]

This Statement goes beyond the minimum statutory requirements and also discusses:

- the performance of the Crown's major assets and liabilities
- how effective ownership and stewardship of assets can complement governments' public policy objectives
- Crown risk management issues, and
- the importance of fiscal sustainability.

The Statement is divided into three parts. *Part One* outlines the purpose of the Statement and provides strategic context. *Part Two* describes the current size and composition of Crown assets and liabilities and examines a range of non-financial indicators of performance. *Part Three* examines many of the principles of efficient and effective balance sheet management and assesses the performance of the public sector management system against those principles.

Improving transparency in the public sector

New Zealand is a leader in public sector transparency. This Statement is one of a number of publications that the Treasury produces to provide transparency around the Crown's finances. Other reports include the *Financial Statements of the Government of New Zealand (FSGNZ)*, the *Economic and Fiscal Updates (EFU)* and the *Statement on the Long-term Fiscal Position (LTFS)*.

Sources of information

Information contained in this Statement is based on a variety of sources.[2]

Historical financial data are based on the *FSGNZ* for the year ended 30 June 2013, with some additional supporting information collected by the Treasury. Forecasts and projections on the size and composition of the balance sheet are based on the *2013 Half Year Economic and Fiscal Update* (*HYEFU)* and *2013 LTFS* respectively.

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1 See section 26NA of the PFA.

2 Unless otherwise stated, all information is based on June financial years.

The detailed non-financial performance analysis cited in Chapter Four is based on management information that was provided to the Treasury by various Crown agencies. While some of this information may have been previously disclosed publicly, some of it was provided, or created specifically, for this Statement.

Chapter 2: The Importance of Balance Sheet Management

...Taxpayers make a large investment through the Crown balance sheet. Efficient and effective balance sheet management supports the delivery of government objectives, economic growth and social outcomes, now and in the future. This improves living standards...

Introduction

Governments have a myriad of social and economic policy objectives. These evolve over time as governments respond to ever-changing expectations around the appropriate role of the state in the provision of public goods and services.

From a public policy perspective, there is general agreement that governments should focus on objectives where private sector provision is unlikely to be adequate. It is also accepted that governments have a vital role in policy setting to create an environment that supports economic growth and stability.

All public policy objectives have a number of ways of being delivered on and these have financial implications. Public sector financial reporting was developed to inject transparency and accountability to these activities, and to allow for more informed decision making. The New Zealand public sector has long been a leader in this regard, being the first to produce a comprehensive sovereign balance sheet according to independent accounting standards.

This transparency and accountability has had many benefits. The production of the first balance sheet in the early 1990s acted to highlight the size of the challenge to sustainably manage the Crown's finances. This led to further proactive measures to prudently manage Crown debt and other liabilities. These measures assisted the Crown in achieving a strong financial position from which to respond to subsequent international economic and financial crises, and natural disasters at home.

The Crown balance sheet

The Treasury produces the FSGNZ ten times a year. As part of these accountability reports, a Statement of Financial Position (balance sheet) is produced in conjunction with other financial reporting, in particular the Statement of Financial Performance (operating statement).

The Crown's balance sheet represents an account of what it owns and owes, and the net worth attributable to taxpayers at a point in time. At 30 June 2013, the Crown's balance sheet consisted of $244.4 billion of assets, $174.4 billion of liabilities and $70.0 billion of equity. Total assets alone were worth more than the output of the entire economy in a year.

The balance sheet reflects the decisions and financial performance of successive governments, partly through its relationship with the operating statement (see Figure 2.1). It is large and complex, consolidating the effect of activities, assets and liabilities from a wide variety of Crown-controlled entities.[3] Assets and liabilities of agencies including departments, Crown Entities, State-owned Enterprises (SOEs) and stock exchange-listed Mixed Ownership Model (MOM) companies are all accounted for in the Crown balance sheet.

The standards by which FSGNZ are produced, called Generally Accepted Accounting Practice (GAAP), define the criteria for measurement and qualification for recognition in the accounts. The balance sheet and its associated notes help provide a detailed picture of the strengths and weaknesses of the Crown's finances.

However, the Crown's balance sheet does not always recognise assets or liabilities that may be intangible, contingent, prospective or implicit and therefore may fall outside the accounting recognition criteria set by GAAP. Unrecognised items are generally policy commitments that are not contractually binding, such as superannuation or welfare benefits. The ability to tax, which is likely to be the Crown's largest intangible asset, is similarly not recognised. These matters are discussed more fully in Box 2.1.

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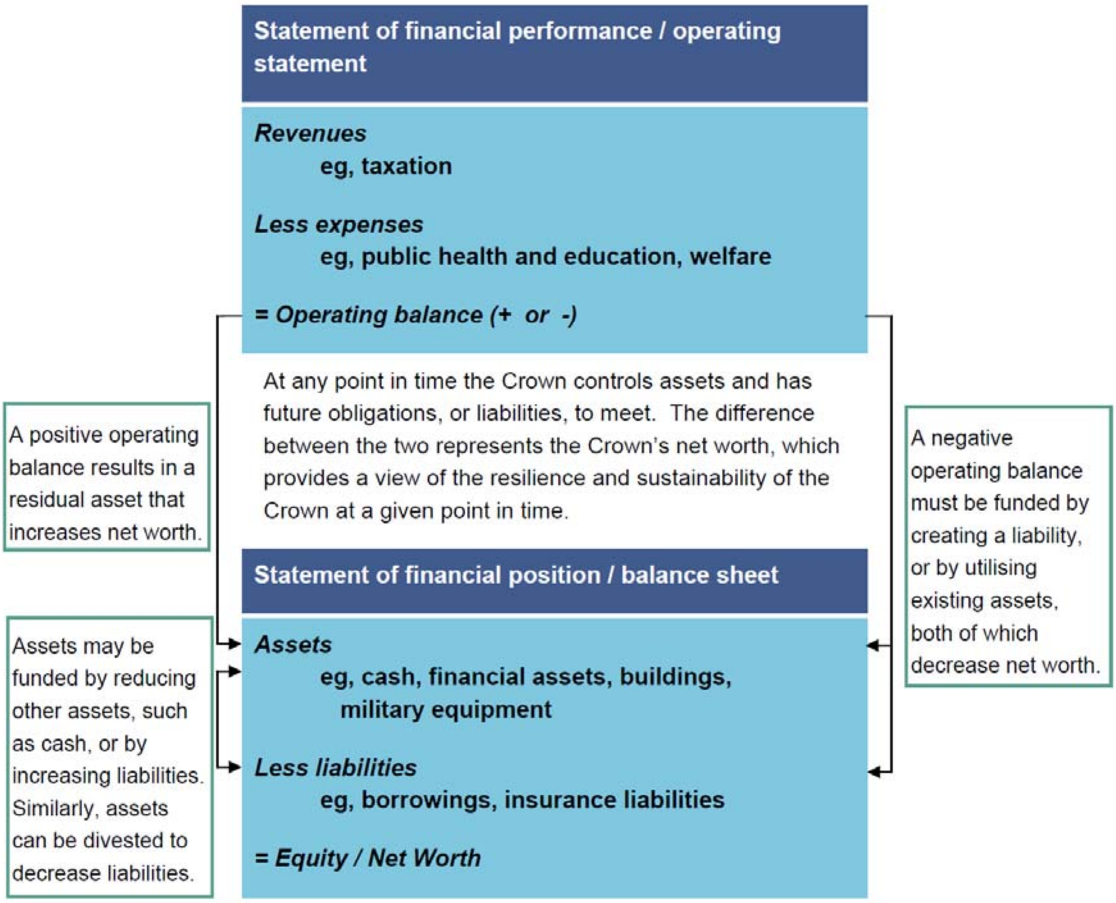
3 A small number of assets are recorded as equity investments. Local authorities are not represented in the Crown's financial statements because they are separate entities not controlled by central government.

***Figure 2.1* –** The balance sheet and the operating statement



Source: The Treasury

Box 2.1 – The "comprehensive" balance sheet

GAAP seeks to establish the financial information that is most relevant for accountability and decision making purposes and that best represents economic reality, within the constraints of cost and materiality. For these reasons, it is the best set of rules and conventions for the Crown to measure its assets and liabilities.

However, there are many other known (and unknown) items that may also be seen to be Crown assets or liabilities that do not comply with GAAP conventions. The fact that something is not recognised in the formal financial statements does not mean that it should be ignored.

The impact of future cash flows and contingencies

A comprehensive balance sheet seeks to address GAAP limitations by recognising a wider range of items that represent the net present value of expected future income and expenditure streams. This provides a greater understanding of the financial impacts of running current fiscal policy into the future, which are often very large given the role that the Crown plays in raising taxes and spending on welfare, health and education over time. Other contingent or implicit assets and liabilities may also be recognised. The Crown's comprehensive balance sheet position is not routinely reported on, nor is it part of the FSGNZ.

The comprehensive balance sheet could be an important tool for the management of Crown finances. Considering the balance sheet in this manner could show a more comprehensive net worth position that better reflects whether the Crown will be able to meet its obligations as they occur in the normal course of events. A significant positive balance would suggest that there is scope to reduce tax or to increase public services, whereas a significant negative position would imply a clear signal that the opposite is the case. The comprehensive balance sheet can also support better management of the large array of risks that can potentially impact on the Crown's finances.

Providing effective stewardship – a closer look at Crown-owned land

The balance sheet provides a snapshot of the assets, liabilities and equity of an entity and an important function of it is to give an account of the financial stewardship of that entity. This can be difficult due to the inherent difficulties in valuing many 'off-balance sheet' assets. This in turn leads to difficulties in fully assessing the implications of policy decisions on comprehensive net worth.

Conservation land provides a useful example of the implications of valuation challenges. Crown-owned conservation land makes up around a third of New Zealand's land mass and is valued at around $6 billion in the FSGNZ. However, this does not consider the value of the minerals held beneath or on the land, nor does it attempt to include the social, cultural and economic benefits of the estate, such as for recreation and tourism purposes. Considering these elements when assessing value could markedly increase the overall value of conservation land.

While the extraction of resources from the estate to realise this value may have significant benefits to GDP, it does not provide a full account of the consequences of such activity. This depletion of mineral stock reduces future benefits for subsequent generations. For accountability reasons, policy decision makers need to weigh the current implications of such policy decisions, both benefits and costs, against the opportunity costs for the future, which could be assisted by considering the comprehensive balance sheet.

Importance of the balance sheet in meeting government objectives

Effective management of the balance sheet has a key role to play in supporting governments to meet their objectives. A well-managed balance sheet is one which both supports the provision of state-funded services while also underpinning the overall economy's performance, and contributes to increasing living standards.[4]

The state sector and government policy

Governments act on behalf of all New Zealanders to deliver services as efficiently and effectively as possible. Effective balance sheet management supports this objective by minimising the cost and maximising the benefits of holding assets and liabilities. The importance of providing value for money is discussed further in Box 2.2.

Effective management of the balance sheet allows the government to achieve an equitable distribution of benefits, costs and risks across current and future generations. Debt allows the cost of investments to be spread over their useful lives meaning that those that benefit contribute to the cost. Saving through the balance sheet also allows for the cost of future expenses to be met by those who benefit from them.

Box 2.2 – The importance of value for money

Crown assets come with an ongoing cost. Based on the public sector discount rate the opportunity cost of Crown asset ownership is around $25 billion per annum. This does not include the costs of utilisation, or upkeep. Capital is not free. Capital that does not provide benefits greater than the costs of ownership incurs costs on citizens.

To put the Crown's balance sheet size into context, there were approximately 4.5 million people living in New Zealand at the end of the last financial year. That means the Crown owned about $54,000 worth of assets and owed $39,000 in debt on behalf of every New Zealander at that time. That means many families' indirect share of the Crown's assets and liabilities would typically be second only in value behind the family house and mortgage.

People expect governments to make the best use of these assets and to manage liabilities to minimise costs. Achieving this allows for more and better public services – more schools or better healthcare for example – or lower taxes, which increases incomes.

[4] http://www.treasury.govt.nz/abouttreasury/higherlivingstandards

Economic growth

An efficiently managed balance sheet saves taxpayer dollars. It also supports a productive public sector and reduces the chances of public spending reducing private sector activity. Productivity is critical to economic growth, increasing national wealth and living standards. With the Crown contributing approximately one fifth of New Zealand's national output each year, even a small improvement in public sector productivity would have a significant positive effect on the wider economy.[5]

A stable economic environment is one of the basic requirements for strong economic performance. Managing public finances well has clear links to this goal. A strong and well managed balance sheet supports fiscal policy by allowing the effects of economic cycles to be met without the need for destabilising tax or expenditure changes. At a minimum, operating revenues should equal operating expenditure over the economic cycle, with debt being used only to fund investment.

Governments with a strong balance sheet have more flexibility to manage the investment cycle in alignment with the wider economic cycle. For example, a number of infrastructure projects were brought forward supporting economic growth during the recent economic slowdown as a result of the global financial crisis. On the other hand, too much stimulus as the economy reaches capacity could push up interest rates, put upward pressure on the exchange rate and increases pressure on the tradable sector.

A strong balance sheet supports a favourable credit rating and lowers the cost of capital for government and domestic borrowers, which helps support increased productive investment. Even after the effects of the global financial crisis and the Canterbury earthquakes, both of which resulted in an increase in Crown debt, New Zealand's credit rating remains strong and it is one of the highest rated sovereigns in the world (see Figure 2.2).

A strong Crown balance sheet can also help manage the effects of shocks that may otherwise have a major destabilising effect on a country. It also allows for the sharing of consequences among individuals and across generations that would otherwise fall unevenly.

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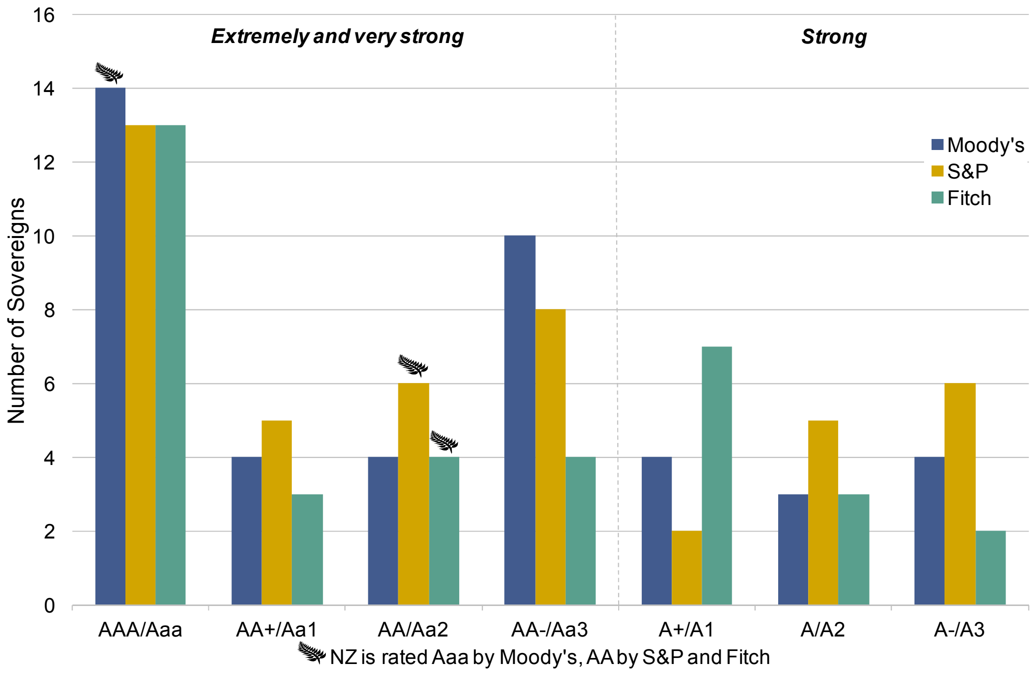
5 This represents central government's operating and capital output, but excludes Crown expenses such as transfers, depreciation and debt servicing.

Figure 2.2 – Foreign currency sovereign credit ratings



Source: The Treasury

Imbalances and structural problems in the economy can be assisted by balance sheet management. For example, New Zealand has a relatively high net external debt position, primarily reflecting that the private sector, including households, on average spend more than they earn. Also, New Zealand's sources of foreign earnings are relatively narrow, mainly from commodity based exports. These factors make the economy susceptible to any abrupt changes in demand or in perceptions about economic resilience. Governments' fiscal policy settings have generally been set to offset high private sector borrowing in recognition of these risks.

Balance sheet management

Balance sheet management refers to a number of actions, including:

- managing the assets and liabilities that make it up, including making decisions about what assets to buy or sell or liabilities to incur or retire
- managing Crown finances appropriately through fiscal policy settings, using Crown debt to help manage the impact of economic cycles and/or to bring forward or defer spending
- managing off-balance sheet assets and liabilities, including the impacts of policies on future balance sheets and contingent or implicit liabilities, and
- utilising the balance sheet to meet public policy objectives, such as saving now to meet future expenses or vice versa.

Effective balance sheet management requires an overarching strategy that brings together these actions in a cohesive manner. The use of specific performance targets can bring further discipline to this process.

Structuring government to meet objectives

The Crown is a large and complicated collection of organisations that serve many different purposes.[6] A key objective is to create institutional arrangements which maximise agency performance while aligning with government priorities. This has implications for agency autonomy.

Government organisations operate under different Acts according to their circumstances and have different governance structures. Government departments or ministries perform core government roles that generally require greater Ministerial involvement.[7] Crown entities, SOEs and MOM companies are legally separate from the core Crown and typically have more discretion in their operations.[8]

The performance of the balance sheet therefore reflects decisions made by a diverse range of entities. Ministers have differing degrees of control over Crown organisations, which has implications for balance sheet outcomes.

Cost centres and revenue centres

The characteristics of public sector organisations have implications for the way their performance is understood.

A cost centre is part of an organisation that does not produce direct profit but does add to the cost of running the organisation. It either adds value indirectly or fulfils another purpose that cannot be measured using only financial results. Private sector examples of cost centres include research and development departments, help desks and customer service/contact centres.

A revenue centre is accountable for revenues and costs, and hence profits. Profit centre management essentially means running a stand-alone business, and financial results are an important signal of good performance.

On these definitions, much of what the Crown delivers is done through cost centres. For example, the provision of health and education services are largely funded centrally, and those working in these areas are not expected to earn revenue from their operations.

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6 See Appendix one for a list of the entities included in the Crown balance sheet.

7 Some departments have specific functions that must be performed independently of Ministers such as the IRD making decisions on individual cases.

8 http://www.treasury.govt.nz/publications/guidance/publicfinance/pit2011

A rule of thumb is that the closer proximity a function is to the core Crown the more likely it is that it will be delivered by a cost centre.

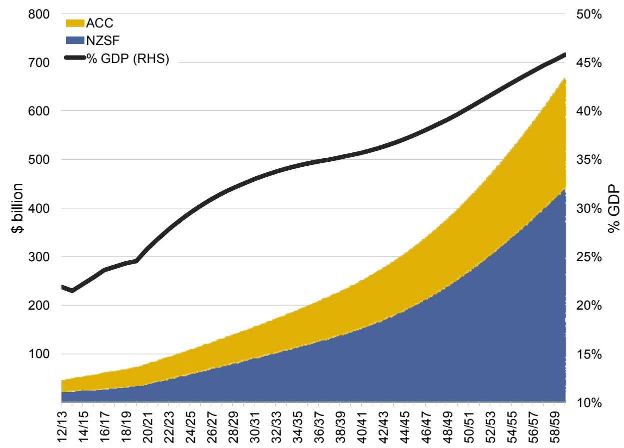
In turn, this means that measures other than financial results are needed to assess their performance. The requirement to have good non-financial performance information is echoed in the findings of this report. This is not just a public sector issue; it is a common problem in large corporations with internal cost centres.

Looking to the future – preparing for demographic change

In its 2013 LTFS, the Treasury projected the scale of the Crown's long-term fiscal challenges arising from major changes in population size and structure.[9] In particular, it highlighted the growing pressures on future health sector and superannuation expenditure from a changing population and income increases.

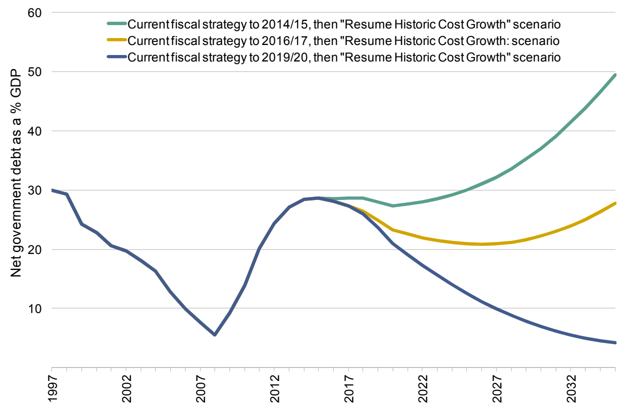
Current policy settings to partially prefund this future increase in New Zealand superannuation through the New Zealand Superannuation Fund (NZSF) will result in a larger Crown balance sheet, which makes the quality of its management even more important. In particular, the Treasury projects that Crown financial assets will continue to grow and form a greater proportion of the Crown balance sheet in the decades ahead. These financial assets are projected to constitute well over $600 billion, or 45% of GDP, in 2057/58 (see Figure 2.3). This will have major implications for the Crown balance sheet as well as for the wider economy.

Figure 2.3 – Projected financial assets



Source: The Treasury

Figure 2.4 – "What if" paths for net government debt



Source: The Treasury

9 http://www.treasury.govt.nz/government/longterm/fiscalposition/2013

Beyond accumulating financial assets, the LTFS highlights the need for continued prudent fiscal management so future governments are in a better position to manage these cost pressures. A well managed balance sheet can help reduce these fiscal pressures through providing services at a lower cost. As the LTFS shows, small changes now can have large effects in the future. Managing the balance sheet well now can have a material effect on future welfare. See Figure 2.4 for net government debt projections under three different fiscal strategy scenarios.

Area of focus

- Governments should consider the use of specific performance targets in meeting the requirements under the *Public Finance Act* to outline a strategy for managing the Crown's capital and balance sheet.