Tayla Forward and Madeleine Foreman

The Debt Ceiling and its Discontents

Abstract

This article challenges the New Zealand Treasury's 2022 recommendation of a 50% debt-to-GDP ceiling, arguing that the analysis undertaken does not justify the recommendation, and that it contains structural biases favouring fiscal restraint over productive investment. We demonstrate that the Treasury's conservative assumptions about the macroeconomic environment for debt consolidation, combined with excessive shock buffers, lack sufficient analytical justification. Replicating Treasury's analysis with more realistic assumptions yields substantially higher sustainable debt levels. We discuss the asymmetric treatment of fiscal risks, where debt costs are precisely quantified while the benefits of public spending and risks of underinvestment are treated as secondary or speculative. We argue for balanced fiscal frameworks that recognise both excessive debt and chronic underinvestment as threats to sustainability.

Keywords fiscal sustainability, debt ceiling, public investment, fiscal credibility, sovereign debt

Tayla Forward is a research associate in economics and political economy at Victoria University of Wellington and the University of Canterbury, and a fellow of the World Inequality Lab, Paris School of Economics. She is a former Treasury analyst and economic advisor to Grant Robertson as minister of finance. **Madeleine Foreman** is a senior policy advisor, Parliamentary Services, to the Green Party of Aotearoa New Zealand and a former Treasury analyst.

In New Zealand, the need for fiscal restraint has largely become an article of faith across successive governments. Despite consistently low public debt levels by international standards, recent decades have been characterised by systematic underinvestment in infrastructure, climate resilience, and public goods and services, attended by a deterioration in real economic capacity and productivity which threatens long-term prosperity potentially more than a 'deterioration' in any fiscal indicator is likely to. The National-led coalition government has pursued further fiscal conservatism since 2023, adopting debt and spending targets more restrictive than Treasury's recommendations.

Observing the pressures from housing shortages, transport bottlenecks, underfunded public services and climate adaptation that demand substantial public investment, what is it that 'fiscal sustainability' is sustaining? Justifications for ever-tighter fiscal restraint tend to make appeals to a greater prudence and responsibility necessary in the context of a small open economy vulnerable to natural disasters. Yet investment to mitigate these vulnerabilities, many of them induced by

Box 1: Fiscal indicators and rules

Measure	Current measure and forecasts (Budget Economic and Fiscal Update 2025)	Current rule
Net debt-to-GDP: the Crown's financial liabilities (primarily bonds) minus its financial assets, expressed as a percentage of GDP.	42.7% in 2025 (at BEFU 2025), expected to peak at 46.0% of GDP in 2027/28	Put net core Crown debt as a percentage of GDP on a downward trajectory towards 40%, and maintain it within a range of 20% - 40% of GDP
OBEGAL: operating balance before gains and losses. Core operating revenues minus expenses, excluding gains and losses (such as changes in asset values). OBEGALx refers to OBEGAL with the Accident Compensation Corporation (ACC) excluded.	2.3% OBEGALx deficit in 2025. Remains in deficit across the forecast period, with the first surplus pushed beyond the forecast period (i.e. after 2028/29). In 2027/28, when the Government's short-term intention is to achieve an OBEGALx surplus, a deficit of $2.2 billion is now expected.	Return the operating balance (before gains and losses) to surplus by 2027/28.

emaciated public services, is made to appear impossible. There is a deference, more or less explicit depending on the government of the day, to the private sector to take up our collective challenges and meet collective needs. But conditioning progress towards our collective ambitions on private profitability is no longer viable, if it ever was.

This article critically examines Treasury's analytical approach to determining a reference point for sustainable public debt in New Zealand. First, we trace the analysis leading Treasury to revise its recommended debt ceiling in 2022, and argue that the analysis does not provide a sufficient justification for the recommended debt ceiling. We then discuss an asymmetry in how fiscal sustainability is conceptualised: while the costs of debt are meticulously quantified, the possible productive effects of public spending – and the risks of underspending – are not integrated into macroeconomic and fiscal models. This creates a structural bias towards lower debt levels and higher operating balances than may be economically optimal, while understating the risks and costs of underinvestment.[1] We argue that a fit-for-purpose fiscal framework would recognise both excessive debt and insufficient public investment as equally unsustainable, and would align fiscal strategy with New Zealand's real economic constraints and investment needs.

Fiscal governance in New Zealand – credible commitments rather than rules

The fiscal strategy is the government's plan to manage revenue, expenses and balance sheet position over time. The fiscal framework, set out in the Public Finance Act 1989 and later incorporating the 1994 Fiscal Responsibility Act, describes how a government's fiscal strategy is to be determined and reported.

The Public Finance Act requires governments to specify and transparently communicate their fiscal strategy as long-term objectives and short-term intentions through Budget policy statements and fiscal strategy reports. While the Act's principles for responsible fiscal management (Box 1) provide an accountability framework, they do not include legally binding numerical targets. Governments typically fulfil these requirements through fiscal rules – quantitative targets for fiscal indicators such as debt ratios, operating balances, and expenses as a proportion of GDP – which must align with the Public Finance Act's fiscal responsibility principles (see Table 1). Critique of those principles and their consequences – intended and unintended – is taken up by Bertram (2025).

To recapitulate: a government must commit to a fiscal strategy consistent with the fiscal framework set out in the Public Finance Act. Conventionally these commitments have taken the form of fiscal rules, which it communicates publicly, giving an account of how the approach reconciles with the principles of fiscal responsibility set out in the Act. Fiscal rules have generally taken the form of quantitative targets, levels or goals for particular fiscal indicators – typically debt ratios, operating balances and, more recently, expenses as a proportion of GDP.

New Zealand's fiscal framework relies on the public commitment of each government to its own fiscal strategy, rather than the internationally common approach of legislated or codified fiscal targets and rules.[2] Public communications are to serve as an accountability mechanism, with deviations from the communicated strategy to be punished by voters or market reactions which have an impact on borrowing conditions; there are no disciplinary procedures written into the fiscal framework itself. Departures from the principles are only to be temporary, and impose a potentially high reputational or political cost, even during periods when different policy choices might have been economically justified. In this way, fiscal rules help to operationalise a fiscal strategy by acting as a commitment device for the self-enforcement of a government's fiscal strategy. Setting fiscal rules which lack credibility, or failing to abide by those set, could 'unanchor' confidence in the delivery of the fiscal strategy, leading to a market reaction which raises a government's borrowing costs. This is not dissimilar to the anchoring of inflation expectations by the forward guidance of a central bank. The enduring fiscal framework remains a source of structure and stability, even as fiscal rules themselves may change.

New Zealand's principles-based (rather than rules-based) fiscal framework is designed to provide policy flexibility while maintaining fiscal discipline. There has never been a recognised 'transgression' of the principles of fiscal management since their establishment. It is not clear what this would mean, nor how a transgression would be validated. Fiscal rules carry no legal force or binding obligations. The public accountability mechanism and threat of market reaction have proved to be sufficiently disciplinary to make legal enforcement unnecessary. In fact, governments have often made

commitments that are more constraining than the letter of the Act would require. The Budget responsibility rules agreed by the 2017 Labour–Greens government, for example, committed the parties to reduce net Crown debt from 24.6% to 20% of GDP (on the previous debt measure) within five years and maintain government expenditure within 30% of GDP – targets that are arguably more restrictive than the Public Finance Act principles demand, designed to counter perceptions that fiscal prudence was the exclusive domain of conservative parties.

If fiscal rules change from those communicated previously, governments need to explain how the amended intentions and objectives accord with the principles of responsible fiscal management. Take the current government repeatedly deferring its previously signalled return to surplus, for example, justifying the repeated deferrals by reference to economic headwinds and cyclical considerations not previously forecast, arguing the consistency of the deferrals with long-term fiscal sustainability, and framing the shifts as manifestations of rather than departures from responsible fiscal management.

What is being 'sustained' when we pursue fiscal sustainability? In orthodox terms, a fiscal strategy is considered sustainable when it is unlikely to lead to explosive debt, avoiding debt dynamics that become self-reinforcing, with debt levels escalating beyond what is plausibly serviceable. 'Explosive' has a specific meaning. 'Explosive' does not mean 'high'. Many countries maintain high debt-to-GDP ratios indefinitely without crisis, while others face explosive dynamics at much lower levels. The opposite of explosive is not 'low', it is 'stable'. What, then, destabilises debt? When markets perceive heightened default risk – whether from deteriorating economic fundamentals, political instability or governance failures – they demand higher interest rates. Higher borrowing costs increase debt service burdens, validating initial concerns and potentially triggering further rate increases. Debt ratios matter only in so far as they signal underlying economic weaknesses or governance problems that might trigger this dynamic. Fiscal sustainability in these terms centres on maintaining market confidence to avoid a sudden slip from stable to explosive debt trajectories. What is being sustained is access to financing on reasonable terms. It is not with reference to a legal interpretation of the principles or to economic substance that fiscal responsibility is defined and pursued. Rather, it is post hoc validation: the absence of an escalating market response tells us after the fact whether a fiscal strategy is being deemed sustainable by financial market actors.

The concern for market perceptions permeates fiscal decision-making processes. Treasury analysis frequently highlights potential market responses when evaluating policy options, and consistently refers to the confidence of financial market actors, including credit ratings agencies, going as far as to say:

> While short term deteriorations in the fiscal outlook and a one-notch downgrade in the credit rating would not be expected to generate a noticeable increase in the cost of debt, it is important to bear in mind that confidence is difficult to build and easy to lose. (Treasury, 2023c)

The fiscal framework centring on the Public Finance Act aims to operationalise fiscal sustainability by providing a durable framework for governments to make transparent, credible commitments, signalling sound governance to potential creditors. It is less about the economic substance of any given numerical targets than about the institutional capacity for consistent, predictable policymaking. This credibility – built as governments demonstrate their ability to make and honour commitments – forms the foundation of market confidence, more crucial for fiscal sustainability than the content of any particular set of fiscal rules. There is no necessary economic basis for a reference point for what constitutes a prudent debt-to-GDP ratio; there are only more or less credible claims about what governments can deliver, given prevailing and expected economic conditions.

However, despite the benefits conferred by its durability, the Public Finance Act is an imperfect support for fiscal sustainability, because it subordinates other policy areas to the imperatives of fiscal management. The performance of fiscal responsibility and maintenance of credibility need not accord with real economic substance; indeed, they cannot accord with economic substance while maintaining the faulty neoliberal precept that government is inherently unproductive, production only occurring

Box 2: Public Finance Act, Section 26G: Principles of responsible fiscal management

The Government must pursue its policy objectives in accordance with the following principles (the principles of responsible fiscal management):

a. reducing total debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total debt in the future by ensuring that, until those levels have been achieved, total operating expenses in each financial year are less than total operating revenues in the same financial year; and
b. once prudent levels of total debt have been achieved, maintaining those levels by ensuring that, on average, over a reasonable period of time, total operating expenses do not exceed total operating revenues; and
c. achieving and maintaining levels of total net worth that provide a buffer against factors that may impact adversely on total net worth in the future; and
d. managing prudently the fiscal risks facing the Government; and
e. when formulating revenue strategy, having regard to efficiency and fairness, including the predictability and stability of tax rates; and
f. when formulating fiscal strategy, having regard to the interaction between fiscal policy and monetary policy; and
g. when formulating fiscal strategy, having regard to its likely impact on present and future generations

in the private sector (see also Bertram, 2025). Governments are then compelled to maintain superficially healthy fiscal indicators through asset sales, deferred maintenance or cuts to productive spending, while weakening the economic foundations that support long-term fiscal sustainability. The appearance of fiscal prudence becomes more important than making economically sound decisions. This can lead governments to prioritise the appearance of fiscal discipline over policies that would genuinely strengthen the economy's longer-term capacity to service debt. Essential investments in infrastructure, education, health systems and climate resilience may be deferred or abandoned not because they lack economic merit, but because they conflict with short-term fiscal metrics.

This disconnect between fiscal performance and economic substance is particularly problematic when markets themselves recognise that rigid fiscal constraints may foreshadow poor governance. When governments sacrifice necessary services or investments or impose pro-cyclical austerity to meet self-imposed targets, they may increase rather than decrease genuine fiscal risks in the long term, even while appearing to strengthen their fiscal position according to conventional metrics.

Calibrating the debt ceiling

In 2022, Treasury drove advice on the recalibration of the fiscal rules following the immediate Covid-19 response, saying: 'as uncertainty from COVID-19 diminishes, we consider that more definitive fiscal targets should be adopted to enable transparent and robust fiscal management' (Treasury, 2021). Following that advice, and alongside other changes to fiscal indicators,[3] Grant Robertson as finance minister raised the level of the debt ceiling to 50% of GDP (net core Crown debt, excluding the New Zealand Superannuation Fund (NZSF) – equivalent to 30% including NZSF), stating, 'in the past our debt targets have led to underinvestment', and that the new debt ceiling would 'provide fiscal space to fund high quality capital investments that improve productivity and wellbeing' (Robertson, 2022). There was no market reaction, signalling the credibility of higher debt levels from the perspective of financial market actors.

> There is no necessary economic basis for a reference point for what constitutes a prudent debt-to-GDP ratio; there are only more or less credible claims about what governments can deliver, given prevailing and expected economic conditions.

Again, the credibility of the commitment to keeping to a fiscal rule is more important for forestalling market reaction than the levels themselves, and there is no prior economic basis determining what constitutes a prudent debt-to-GDP ratio. There are only credible or non-credible claims about what a government can deliver. How, then, did the Treasury arrive at its recommendations for the debt ceiling, which it has restated consistently in advice since 2022?

Fiscal strategy decisions involve judgements under conditions of significant uncertainty about the economic outlook. There is nothing deterministic about calibrating fiscal rules. In Treasury's words: 'While some fiscal and debt positions will be clearly incompatible with the sustainability and stability criteria, a wide range of fiscal and debt positions may be compatible with them' (Treasury, 2022c).

Tracing the approach to the recommendations through Treasury advice, we can show that varying key assumptions while using the same analytical procedure as was the basis for the 50% recommendation permits far less restrictive fiscal rules. First, we address the excessive conservatism in Treasury's calibration; then we turn to the underlying pessimism towards the productive potential of public spending. The argument in the first instance will not be that a higher debt ceiling is credible, simply that the analysis doesn't provide sufficient grounds for the ceiling we have.

To recommend fiscal rules, Treasury follows a standard, internationally common IMF procedure. The method implicitly considers there to be no benefit to public spending (either through debt-financed investment or through current expenditure), and no differentiation between spending on different things, issues we return to later.[4]

Treasury estimates a level of net debt (excluding the NZSF) as a percentage of GDP that it claims we have very little room to exceed, under threat of financial markets deeming the government likely to default and withdrawing lending. This is, of course, a speculative exercise, not a process of discovering a structural parameter in the New Zealand economy. Following the debt dynamic equations (Box 2), there are two inputs[5] into the computation:

1. Maximum feasible primary balance: the amount by which revenue could exceed expenses, using the difference to pay down debt. This determines the ability of the government to stabilise and reduce net debt when it is at high levels. This is a judgement made in reference to historical experience: Treasury uses a primary surplus of 2–3%. A higher average primary balance was achieved in the period between the global financial crisis and the onset of the Covid-19 pandemic, so such balances can be seen as feasible, though willingness to raise adequate tax revenue is likely to be an important part of doing so in future.
2. Interest rates and GDP growth rates: the difference between the interest rate

on government bonds and the growth rate (r-g: 'r minus g') determines the rate at which debt grows (or reduces) as a percentage of GDP if the primary balance is zero – referred to as 'automatic debt dynamics'. All else being equal, the higher the assumed long-run interest differential, the lower the maximum level of sustainable debt. As we will elaborate on below, Treasury's analysis incorporates a very pessimistic interest differential.

With these assumptions, Treasury estimates a maximum tolerable debt level (excluding the NZSF) of 90% of GDP. A buffer is then subtracted from this level to set the debt ceiling. This buffer reflects an 'extreme but plausible' shock of 40%.

> We consider this adequate to absorb a range of shocks, from an average sized shock of 10 per cent of GDP, which is likely over a decade, to a large shock of 40 per cent of GDP, which has a low likelihood of materialising in any given decade. This buffer assumes a high degree of risk aversion and allows for the larger end of possible shocks, or multiple shocks in a short space of time. (Treasury, 2022b)

The result is the 50% ceiling for the debt-to-GDP ratio Treasury recommended in 2022, saying:

> We recommend a debt ceiling of 50% of GDP (current net debt measure) based on assumptions around risk tolerance, the primary balance required for reducing debt after large shocks and ensuring adequate fiscal space. The framework we introduce here can be used with different judgments and may lead to different results on the level of the debt ceiling, depending on how different factors are weighed. (Treasury, 2022c)

The current government opted to push this further, adopting a long-term objective of debt between 20% and 40% of GDP.

Critique and recalibration

The calibrations Treasury reaches are explicitly 'conservative': 'making assumptions about future economic conditions, which comes with a high degree of uncertainty. Therefore, throughout we drew on evidence and made conservative assumptions … we think making conservative assumptions is a prudent approach' (Treasury, 2022b). Conservative is a slippery term here, because it may be riskier to underinvest (say, in public infrastructure) than to constrain investment excessively. Fiscal policy would look quite different if the same conservative stance were to be taken towards underinvestment as is taken to determine upper limits of fiscal sustainability. Treasury's own description of its approach as 'conservative' reflects an unbalanced consideration of fiscal risks. Treasury 'first aimed to answer the question: what is the highest level of net debt to GDP that could be tolerated before we consider debt to be unsustainable?' (ibid.).

There is a necessary counterpart to this question: what is the *lowest* level of net debt-to-GDP that could be tolerated before we consider debt to be unsustainable?[6] In its own words, Treasury 'set out judgements to support the government in making trade-offs between a prudent level of debt and a prudent level of investment' (ibid.), recognising that underinvestment is in part a consequence of imprudently conservative debt management. Underinvestment threatens longer-term productive capacity in the economy, either by failing to enhance resilience to shocks, or by eroding existing capital (including physical, natural, human and social capital). Falling below a minimum sustainable level of investment is unsustainable, as it precipitates falling economic capacity. They noted: 'our assessment of the amount of public investment needed in the medium-to-long-term is higher than in 2019. Therefore, a 30 per cent net debt target – as recommended in 2019 – would now be likely to overly constrain capital investment in a way that could reduce wellbeing'; 'pursuing very low levels of debt can involve reducing capital investment and passing up on productivity and growth enhancing investments' (ibid.; Treasury, 2022a).

We see that Treasury recognised that previous recommendations had likely constrained investment in a wellbeing-reducing way; hence the upwards revision of its recommended prudent debt levels in 2022. It recognised that too low a debt level is also imprudent. This could be considered a transgression of 'responsible fiscal management' under the Public Finance Act, given that the Act has a one-sided view of sustainability, with no provision for prudent increases in debt, or imprudent decreases in debt. We can reconsider the analyses in a few ways.

Less conservative interest differential

The interest differentials used to arrive at Treasury's maximum sustainable debt levels are higher than historically observed: 'Our analysis had very conservative assumptions of the interest rate exceeding nominal GDP growth (r-g) by three percentage points compared to the long-run average of +0.8 percentage points between 1991 and 2021'; 'a 3 per cent interest rate differential could be considered a tail risk scenario, but to ensure fiscal rules are robust to extreme outcomes, we have used this conservative assumption' (Treasury, 2023b, 2022b).

We demonstrate maximum sustainable debt levels computed with less conservative interest differentials, using a range of 1–2% – still above the 30-year historical average.[7]

Box 3: Debt dynamic equations

Basic debt dynamics are expressed by:

$$\Delta d_{t+1} = \frac{r-g}{1+g} d_t - p_{t+1}$$

Where d is the debt-to-GDP ratio, r is the interest rate the government faces, g is the growth rate of GDP, and p is the primary balance. Approximating by $\Delta d_{t+1} \approx (r-g)d_t - p_{t+1}$ the debt-stabilising primary balance is:

$$p^*_t = (r-g)d_{t-1}$$

Making the stability condition for the operating balance ob:

$$ob^* \approx (r-g)d - rd \approx -gd$$

Or if taking long-run values for r,g, and p, the maximum sustainable debt level d* is:

$$d^* = p\left(\frac{1+g}{r-g}\right)$$

Figure 1: Historic and forecast operating indicators

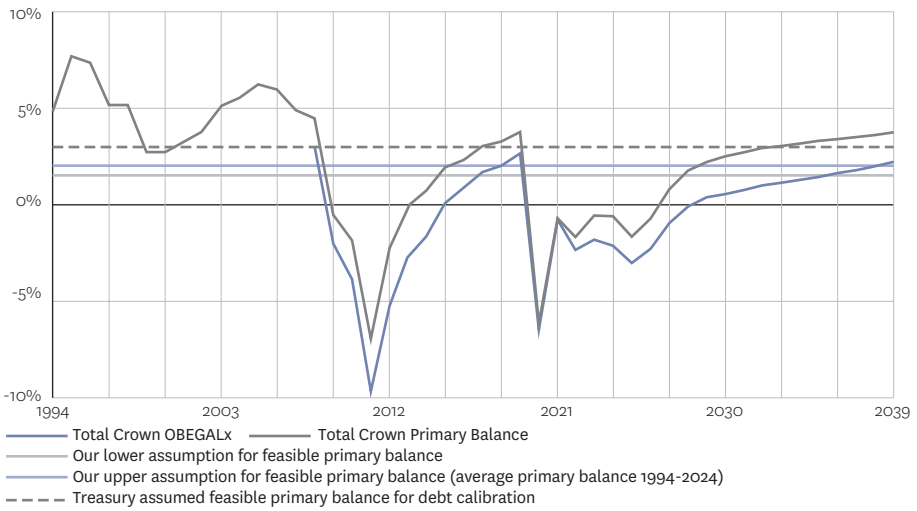
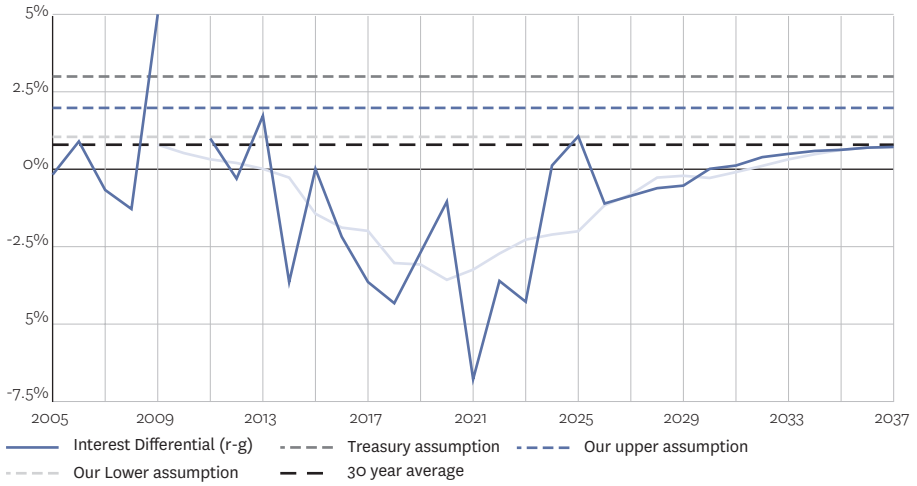


Figure 2: Historic and forecast interest differentials



Treasury's method also takes an assumed maximum feasible primary balance as input. This can be understood as the 'effort' a government is willing and able to put into stabilising debt, by tightening current and future operating expenditure or raising revenue. Table 2 considers debt ceilings corresponding to lower feasible primary balances than those used in Treasury's analysis. These are below balances seen in post-global financial crisis consolidation episodes.

Figures 1 and 2 give historical context to the choice of assumptions concerning the primary balance and interest differential. In Figure 1 we see that high primary balances have been achievable in recent decades, but decreasingly so as the structural deficit (a reflection of tax inadequacy) has emerged. The horizontal lines indicate the demands on primary balances our debt ceiling calibration in Table 2 are premised on – not extreme demands, if the tax system is made adequate. In Figure 2 we see the pessimism of Treasury's assumption (red) on the interest differential – far above the average differential over the last 30 years (grey). It remains low (1% in 2024/25; forecast –0.6% in 2025/26 at BEFU 2025), though Treasury forecasts that it will stabilise at the historical average (0.8%) over the projection period. Our calibrations (blue, gray lines in Figure 2) are based on a macroeconomic environment more conducive to debt consolidation than Treasury assumed, but still more adverse to debt consolidation than the historical average.

Reduce buffers, allow investment in resilience

The 40% buffer, as Toby Moore has recently pointed out, would cover approximately two Covid-19-size shocks occurring simultaneously, more than 23 simultaneous Cyclone Gabrielles, or almost four Canterbury earthquakes (Moore, 2025).

Treasury's August 2025 long-term insights briefing set out to consider 'the appropriate way that fiscal policy could be used in response to future disruptive events to the New Zealand economy and society'. It set out a narrow role for fiscal policy with respect to shocks:

> In the context of higher public debt and increasing fiscal pressures, it is important that the policy choices of governments position New Zealand to weather future shocks by rebuilding and maintaining sustainable fiscal capacity … Key policy choices include constraining public expense growth, improving the efficiency of public expenditure, making more efficient use of the government's balance sheet and increasing revenue through base broadening or higher rates. (Treasury, 2025, pp.13, 79)

They evince no role for strategic, proactive fiscal policy that would reduce the frequency or severity of shocks. The briefing essentially argues that fiscal policy between shocks should focus on fiscal consolidation, debt reduction and building buffers, rather than active investment in productive capacity or resilience. It frames 'normal times' as opportunities to save for the next crisis, rather than periods of strategic investment that might reduce future crisis costs or build economic capacity: merely preparation for the next crisis. We then run into the problem of deciding what constitutes a crisis worth using hard-won fiscal capacity to respond to. This is a judgement; there is no purely technical solution. While Treasury acknowledges that 'building the resilience of the private sector to deal with shocks and cycles may lessen the need for, or the cost of, any fiscal response', it largely does not connect this to fiscal policy levers, suggesting instead that the 'resilience of the private sector' comes from a liberalised market environment: 'Features of New Zealand's economy that keep it flexible and adaptable to change should be maintained' (ibid., p.5).

It appears in the Treasury advice and the long-term insights briefing as though investment has little to do with resilience to shocks. In fact, investment in, say, flood

defences or managed retreat, which has a mechanically 'worse' impact on fiscal indicators, would have a negative impact on resilience as seen by Treasury, because their approach conceives of resilience as financial market accessibility rather than investment in underlying real resilience. This view of investment as a threat to economic resilience, rather than a means to pursue it, fails to take account of the fact that financial markets can and do recognise productive investment in resilience, and are already pricing in the vulnerability induced by underinvestment. It is possible for excessive fiscal buffers themselves to have an adverse impact on borrowing conditions if they contribute to continuing underinvestment in resilience.

The March 2025 S&P downgrade of New Zealand's local government ratings is a concrete example. For decades, councils maintained apparently healthy fiscal metrics while underinvesting in water and other infrastructure, deferring an estimated $120–185 billion in necessary maintenance and improvements, while pointing to balanced budgets and manageable debt levels. However, when this underinvestment culminated in system-wide infrastructure failure – from the Havelock North drinking water contamination to widespread compliance failures – S&P Global Ratings responded by downgrading New Zealand local governments, explicitly citing concerns that councils are not able to cover necessary investment in infrastructure. The downgrade followed the repeal of the Three Waters reform, which had been designed to address the infrastructure deficit. S&P's assessment recognised that fiscal constraint without productive investment creates greater long-term risk than debt-financed infrastructure spending: the rating agency effectively penalised the policy framework that prioritised short-term fiscal metrics over resilience investment. Fiscal constraint maintained through infrastructure neglect eventually led to worsened borrowing conditions, as markets moved to price in the accumulated risks, contingent liabilities and heightened policy uncertainty created by systematic underinvestment.

New Zealand has, from a comparative perspective, a relatively high vulnerability to geophysical and weather-related hazards, and biosecurity risks, that require careful consideration. Risk aversion is reasonable, but that should not be thought of as at odds with proactive fiscal policy. If investment made possible under a higher debt ceiling is able to reduce the frequency or severity of shocks, a buffer less than 40% of GDP would be sufficient, and would not come at the direct expense of financial market accessibility in the event of a shock, as the underlying real economic resources and resilience are looked upon favourably, whereas failure to undertake necessary investment is recognised as a vulnerability, threatening both underlying economic capacity and the stability of the policy environment. Treasury recognised that a 'government may wish to have a buffer towards 30% of GDP … if government wants to attempt to reduce future fiscal pressures or sustainably grow the economy and wellbeing by investing in high value for money initiatives now' (Treasury, 2022c). Having real economic capacity to respond to shocks would support the orderly functioning of financial markets in the event of a major shock. A smaller buffer that allows for better direct preparation for shocks, or reduces the likelihood of a shock of such severity, is better than lying in wait.

Table 1: Recalibrating Treasury's approach to recommending a debt rule

			maximum sustainable debt level (%)			debt ceiling (%)	
			max feasible *pb*			max feasible *pb*	
r (real)	*g* (real)	*r-g*	1.50%	2%	buffer (%)	1.50%	2%
3.00%	1.00%	2.00%	76	101	40	36	61
4.00%	2.00%	2.00%	77	102	40	37	62
3.00%	1.00%	2.00%	76	101	30	46	71
4.00%	2.00%	2.00%	77	102	30	47	72
2.50%	1.00%	1.50%	101	135	40	61	95
3.50%	2.00%	1.50%	102	136	40	62	96
2.50%	1.00%	1.50%	101	135	30	71	105
3.50%	2.00%	1.50%	102	136	30	72	106
2.00%	1.00%	1.00%	152	202	40	112	162
3.00%	2.00%	1.00%	153	204	40	113	164
2.00%	1.00%	1.00%	152	202	30	122	172
3.00%	2.00%	1.00%	153	204	30	123	174

Notes: *r* refers to the interest rate on public debt, *g* is the real GDP growth rate, *pb* is the primary balance

Replicating Treasury's debt sustainability analysis with different assumptions shows that it is not a strong justification for the recommended debt ceiling; as we see in Table 2, the same method delivers far higher sustainable debt levels under plausible and unrestrictive assumptions. This exercise has simply demonstrated the effect of revising the assumed interest differential, feasible primary surplus and required buffer on the estimated maximum sustainable debt level and the debt ceiling, with no further benefits to investment incorporated in the modelling. We have done nothing here other than adjust the assumptions in Treasury's analysis to reflect empirically justified values. The point is not that a sudden leap to a debt ratio of 120% is advisable; it is that we do not find a sufficient account for the current recommendations in the method Treasury used.

If we do not find a strong argument for the current debt ceiling in this particular analysis, what is the reason for it? In advice, Treasury presented a 60% debt ceiling as an option. It noted: 'This assumes higher willingness and credibility of governments to run high primary surpluses to reduce debt back to the ceiling level in response to a tail risk scenario' (ibid.). By the same debt dynamic equations in Box 2, Treasury claims that reducing debt from 100% to 60% of GDP requires an average primary surplus of ~4.5% of GDP over a 20-year period. This calculation relies on the same pessimistic interest differential dispensed with earlier.[8] And, again, no economic benefits from either higher debt-financed capital investment or higher operating expenditures are incorporated in such a computation. Still,

this draws attention to the crucial role of the operating balance in securing the credibility of commitments on debt. The credibility of the debt level relies on the credibility of the operating balance, which relies on the adequacy of the tax system.

Debt for productive investments in long-term growth or credible crisis response is viewed favourably by ratings agencies. Debt reflecting an inability or unwillingness to steward a tax system is not. New Zealand's Covid-19 spending was rewarded with a credit rating upgrade because it demonstrated competent crisis response. When Grant Robertson raised the debt ceiling in 2022, telegraphing intent to pursue higher spending and public investment, ratings agencies didn't blink an eye. Clearly it's not the debt level, but the reason for the debt, and what we get from it, that matters to ratings agencies.

Debt for productive investments in long-term growth or credible crisis response is viewed favourably by ratings agencies. Debt reflecting an inability or unwillingness to steward a tax system is not.

Some would emphasise that sudden shifts in approach signal an unpredictable policy environment, which is inherently destabilising. Some argue that New Zealand's historically conservative fiscal policy has conferred economic benefit, and that confidence built through the enduring fiscal framework is hard-won, easily lost, and should not be undervalued. The price at which lenders provide funding is not independent of the commitments a government makes regarding public debt limits; the interest differential may respond to a change in strategy and so there may be a need to move steadily from one strategy to another, taking market actors along and telegraphing sound reasoning.

There are good reasons to limit public debt. Even if there were no threat of financial market reaction, excessive debt can fuel inflation if government spending exceeds the economy's productive capacity to make use of it. There is only so much that can be delivered, given the real productive capacity in the economy and government's willingness to mobilise it, dispensing with other private claims to the same resources by taxation or by regulation. When government spending pushes beyond these real resource constraints – the availability of specific skills, materials, infrastructure and technological capabilities – inflationary pressure will represent a genuine economic limit on fiscal expansion, independent of financial market sentiment. However, this constraint is not fixed: strategic public investment that expands productive capacity can alleviate these limits over time, making higher sustainable debt levels possible.

Real economic constraints on delivering necessary investment

Treasury recognises an infrastructure gap, and the potential for that gap to be closed by tolerating higher debt levels. However, it warns of delivery constraints on investment, referring to limited 'market capacity' to carry out the necessary activity. This is reiterated over several pieces of advice.

> Available estimates point to the presence of an infrastructure gap in New Zealand … However, there are constraints on the pace and scale of investment that can be delivered by both the public and private sectors. The current pipeline of public investment exceeds our estimates of market capacity and may not represent the best value for money. (Treasury, 2023c)

> [There is] an investment pipeline larger than agencies and the market can deliver, leading to cost increases and delivery delays. A more structured long-term pipeline of investments and capital programmes that we have approved and sequenced will support the market to invest in capability and increase capacity, as well as improve deliverability and avoid future pressures. (Treasury, 2023a)

> A debt ceiling of 50% of GDP offers fiscal space for discretionary capital investment … However, there are significant market capacity and capability constraints. Advice from the Investment Panel identified these market constraints (including availability of labour and supply chain issues) as the most acute issues constraining delivery across the Government's capital portfolio. (Treasury, 2022c)

> Agencies' ability to deliver funded investments is limited by market capacity as demand remains significantly higher than supply. Many of the projects within the investment programmes funded over recent years are only just commencing delivery, and supply pressures are exacerbated by additional demand and regional market capacity posed by the cyclone and flood responses. The over-subscription of the pipeline is leading to cost increases and delivery delays. (Treasury, 2024a)

We can agree that the primary constraint on government spending is not financial, but real: the availability of real resources and capacity to deliver on collective ambitions. True constraints on delivering investment lie in the availability and productivity of labour (incorporating the health, education and care of workers), produced intermediate goods, natural resources (incorporating the impact of emissions and extraction on the degradation of the environment, biodiversity and climate), infrastructure, and technological capabilities.[9]

Above, Treasury finds a larger capital investment pipeline to lack credibility, as it exceeds real capacity for delivery. That real capacity should be the reference point for calibrating fiscal rules, with particular

attention to spending that raises real state capacity. Indeed, in Treasury's own words:

> If the pipeline of investments is managed well, resulting in an ongoing and sustained increase in capacity and therefore capital investment (including the large investments noted above), it is likely that even a net debt ceiling of 50% of GDP would require some prioritisation of capital expenditure. (Treasury, 2022c)

Meaning, if the state's capacity to deliver capital investment is sufficiently high, then the 50% ceiling could become an undue constraint forcing the state to forgo productive and feasible investment opportunities.

Treasury's concern for market capacity to deliver an agreed investment pipeline pays some attention to the real economic constraints on public works, but because the possibility of long-run impacts on potential output is missing in the analytical framework, it fails to integrate dynamic effects of strategic investment on expanding capacity to deliver investment, other than suggestively. If greater real economic capacity is required to deliver necessary capital investment, then it is crucial to build or release the necessary economic capacity over time, to alleviate the constraints on delivering on our social ambitions. As that capacity grows, the debt ceiling is decreasingly conducive to the delivery of public investment.

There are two routes, which can be used in tandem to expand real capacity: strategically sequenced investment in alleviating supply-side constraints; and diversion of resources from other, less socially productive uses, by use of stronger regulation that reduces the private claim on the resources that must be reallocated towards socially agreed projects.

Physical infrastructure investment, for example, addresses binding constraints on economic activity. When transportation bottlenecks limit the movement of people and goods, energy constraints hinder production expansion, or housing shortages restrict labour mobility, targeted public investment can relieve these constraints. Credible spending plans should account for how public investment dynamically enhances productivity and economic capacity, thereby improving long-term capacity to deliver necessary investment, in turn making higher debt levels credible. This is what it means to be strategic with public expenditure.

Conclusion

The suite of fiscal and economic models underpinning the advice provided to the government on setting its fiscal rules incorporate fiscal policy changes asymmetrically: incorporating costs, but not capturing the benefits, leading to systematic pessimism about the potential of fiscal policy. Underestimating the benefits of public expenditure means catastrophically underestimating the damage done by cuts and recommending unduly tight restraints on both taxation and the scope of government. A rebalanced analysis would lead to advice that is more insistent on the need for more revenue and less willing to tolerate expenditure-side consolidation.

Concerns about New Zealand's fiscal reputation are legitimate, but the current approach conflates fiscal credibility with fiscal conservatism. Markets assess sovereign risk based on a government's capacity to service debt, which depends more on underlying economic fundamentals and a stable, transparent policy environment than on adherence to numerical targets that may themselves undermine long-term economic capacity. A truly credible fiscal framework would demonstrate commitment to productive investment within sustainable parameters. Systematic underinvestment in infrastructure, human capability and climate resilience will ultimately pose greater reputational risks by signalling a government's inability to address structural challenges that more acutely threaten debt sustainability. Chaotic adjustments and policy instability are more likely to result from implausible underinvestment, as the local government downgrade discussed earlier demonstrated.

Ratings agencies prioritise political stability, effective governance, and real economic dynamism and resilience above simple debt levels. Real economic deteriorations – not surface-level fiscal indicators – are the genuine risks. Productivity stagnation, brain drain, homelessness and infrastructure decay are stains on our economic record – and slow-burning threats to our fiscal credibility. Addressing New Zealand's real economic decline requires more public spending, not less. These are pernicious problems that deference to private solutions will not solve. True fiscal responsibility means ensuring that governments can deliver the public services that underpin a thriving society. It means recognising that real constraints on prosperity aren't found in debt ratios, but in the health and availability of skilled workers, quality infrastructure, technological capabilities, social cohesion and climate-readiness – areas where public investment makes transformative differences.

This analysis has argued that New Zealand's fiscal framework systematically undervalues public investment through unduly pessimistic assumptions about the productive possibilities of the state, and a

> There are public goods and services that private provision is bound to underprovide. If the state does not deliberately build capacity to deliver the accessible, high-quality public services we collectively aspire to, no one will.

one-sided conception of fiscal responsibility wherein the risks of excessive debt are meticulously quantified, while the costs of underinvestment remain largely invisible. Treasury's approach to calibrating a debt ceiling does not provide sufficient support for its current recommendation; the same approach, under unrestrictive assumptions, can support an argument for a far higher debt ceiling. We do not point this out to argue that we should immediately run headlong towards higher debt levels. Rather, we have aimed to show that what constitutes sustainable debt is a matter of contestation and credible commitment.

Treasury's analytical framework, the Public Finance Act and the literature on sovereign debt theory share a compulsion towards debt reduction and containment, with no provision for prudent, productive increases in debt that enhance economic capacity and resilience. This one-sided view creates an incoherence where fiscal 'prudence' can lead to imprudent underinvestment in public goods and infrastructure, ultimately eroding real economic capacity. A more balanced approach to fiscal sustainability would recognise that:

- Public investment can enhance growth, productivity and resilience, improving rather than undermining long-term fiscal sustainability.
- The costs of underinvestment – in infrastructure gaps, climate resilience and human capital – pose risks as significant as excessive debt: both debt in excess of real economic capacity to deliver investment and chronic underinvestment represent failures of fiscal responsibility.
- Not all debt is of equal value. Debt reflecting an inability or unwillingness to steward a tax system is a greater threat to fiscal credibility than productive public investment is. Tax adequacy underpins stable debt.
- Real economic constraints, alleviated strategically and dynamically, should guide public investment decisions, not financial targets divorced from their economic implications.

Such a framework would enable the strategic investment necessary to address New Zealand's infrastructure deficits, build resilience to growing economic and environmental shocks, and create the foundations for sustainable prosperity. There are public goods and services that private provision is bound to underprovide. If the state does not deliberately build capacity to deliver the accessible, high-quality public services we collectively aspire to, no one will. Any fiscal strategy that fails to equip the state to do so will undermine itself, ceasing to be economically or politically sustainable.

1 Much of the discussion to follow will be focused on debt. We do not wish to make an argument for a less alarmist disposition towards public debt without also making an argument for a less alarmist disposition towards taxation. Any comprehensive fiscal strategy must recognise taxation as more than a revenue-raising mechanism. Taxation can and should be a tool for economic rebalancing – resisting increases in inequality, redistributing resources from areas of excess to areas of need, redirecting productive capacity towards public priorities, and managing aggregate demand to maintain price stability. Moreover, as we have discussed elsewhere, the inadequacies of the current tax system pose a greater risk to any notion of fiscal responsibility than do current debt levels.

2 Australia takes a similar principles-based approach, with the Charter of Budget Honesty fulfilling a similar function to the Public Finance Act. Sweden and Denmark operate on a hybrid model that is more rules-based than New Zealand's, each with an important role for independent fiscal institutions. The European Union, with its Stability and Growth Pact, is a prominent example of a rules-based system, as all Eurozone members must adhere to specific numerical targets. Countries like Germany and Switzerland have also enshrined 'debt brakes' into their constitutions, reflecting a strong commitment to rules-based frameworks.

3 Taken together, these changes were to mean less emphasis on the revised debt rule, which would be secondary to the operating rule – a 'backstop against deficit bias'. Treasury recommended focusing on the operating balance before gains and losses (OBEGAL) position as the main fiscal rule, moving more explicitly towards a 'golden rule', where the government borrows to invest in long-lived assets but does not borrow to fund current spending. Such an approach places less weight on a binding net debt target and more focus on the operating position, to provide more flexibility to undertake long-term investments, with less of a top-down constraint on capital spending (Treasury, 2022c).

4 Criticisms from a diverse range of actors have persisted through continual refinements to the DSA (debt sustainability analysis) framework. In a developing country context, Oduk and Mithia (2024) find the DSA's 'limited scope, coupled with its inherent biases, frequently exacerbates the debt challenges faced by developing countries … the DSA inadvertently reinforces a cycle of dependency that undermines true economic sovereignty', while Erce (2025), writing for the European Parliament, noted that in advanced economies the procedures 'understate the impact of public investment … not only unrealistic but prevent investments and fail to reward good policies'. For Laskaridis (2021), the theoretical grounds guiding the IMF's DSA are disconnected from the discipline of economics. There is a clear need to ask how, and why, the IMF defends such a limited analysis.

For Oduk and Mithia (2025), as for Gill (1993), the IMF has institutionalised the DSA not merely as a technical assessment tool, but as a reflection of and vehicle for a preference for market-centric values that prioritise fiscal consolidation, privatisation and trade liberalisation over state-led development strategies. Through its surveillance functions and policy advisory role, the IMF has historically used the DSA to justify structural adjustment programmes, even when these measures prove counterproductive – as evidenced by instances where fiscal consolidation demands have worsened debt sustainability troubles in vulnerable economies. The IMF's unique position as both analyst and influential market actor means that its DSA assessments become self-reinforcing: they shape sovereign lending markets and debt contract structures, creating conditions that validate the sustainability concerns underlying the framework – a sort of circular legitimacy that allows the IMF to maintain the DSA's authority despite its mechanical approach, inflexibility to circumstances, and tendency to understate the benefits of public investment.

5 These are long-run values; short-term fluctuations do not matter.

6 It is beyond the scope of this article to propose a method to determine a minimum sustainable debt level, but we would urge further work on this. We simply note that recognition of a minimum sustainable debt level, neglected in the current approach, implies an unbalanced consideration of fiscal risks which may result in an imprudently restrictive debt ceiling. (For a good summary of economic implications of underspending, see Hall, 2014; Ashauer, 1989; Beraldo, S., et al. 2009; IMF, 2012a, 2012b.)

7 Recent years near the zero lower bound have seen negative differentials, prompting Olivier Blanchard's statement in his now seminal lecture in 2019 that, 'put bluntly, public debt may have no fiscal cost'. Though long-term growth may, if trends persist, be weak, long-term trajectories for interest rates are also being pulled downwards (notwithstanding shocks). Blanchard's subsequent work suggests that safe interest rates are expected to remain below growth rates for extended periods, as 'more the historical norm than the exception'. Auclert et al. (2024) make a similar argument in demographic terms: though demographic change is likely to slow growth and put upward pressure on public spending, ageing countries' saving behaviour may modify public debt demand, leading to sustained lower rates.

8 At a 2% interest differential, an average primary balance of 3.6% reduces debt to 60% over the same period. At a 1% interest differential, the average primary balance required is 2.8%. As in our replications above, debt can be stabilised from high levels with lower primary balances, under reasonable assumptions on the long-run interest differential.

9 As Bertram puts it in this issue (Bertram, 2025): 'In the long run, the two essential issues in setting fiscal strategy should be, first, what are our aspirations as a society; and second, what is society's willingness and ability to "raise sufficient revenue" to fund those aspirations? Upper and lower bounds on government spending should be based not on rigid adherence to arbitrary ratios, but on the outcome of those strategic choices, with due regard paid to the macroeconomic limits which any New Zealand government has to respect: resource scarcity, full employment (defined in a sensible way – see, for example, Rose, 2019), and the balance-of-payments constraints facing a small open economy.'

Acknowledgements

The research on which this article is based was supported by the Paris School of Economics, the Royal Society Mana Tūāpapa Fellowship, and the Green Party of Aotearoa New Zealand. We are grateful to Geoff Bertram, Bill Rosenberg, Ganesh Nana, Susan St John, Rob Campbell, Jack Foster, Jonathan Boston, Jolyon Swinburn, Charles Serfaty and Toby Moore for their input and comments on earlier drafts. Parts of this work have been previously published in the Post.

References

Aguiar, M. and M. Amador (2021) *The Economics of Sovereign Debt*, Princeton: Princeton University Press

Aschauer, D. (1989) 'Is public expenditure productive?', *Journal of Monetary Economics*, 23, pp.177–200

Auclert, A., H. Malmberg, F. Martenet and M. Rognlie (2024) 'Demographics, wealth, and global imbalances in the twenty-first century', working paper 29161, National Bureau of Economic Research

Beraldo S., D. Montolio and G. Turati (2009) 'Healthy, educated and wealthy: a primer on the impact of public and private welfare expenditures on economic growth', *Journal of Socio-Economics*, 38, pp.946–56

Bertram, G. (2025) 'Fiscal irresponsibility and non-accountability', *Policy Quarterly*, 21 (4)

Erce, A. (2025) *Assessing the Debt Sustainability Analysis Methodology in the EU's New Economic Governance Framework*, Brussels: European Parliament, Economic Governance and EMU Scrutiny Unit

Gill, S. (1993) 'Gramsci and global politics: towards a post-hegemonic research agenda', in S. Gill (ed.), *Gramsci, Historical Materialism and International Relations*, New York: Cambridge University Press

Hall, D. (2014) *Why We Need Public Spending*, report for the EPSU and PSI, Brussels: European Federation of Public Service Unions

IMF (2012a) 'Successful austerity in the United States, Europe and Japan', working paper WP/12/190, International Monetary Fund

IMF (2012b) *World Economic Outlook*, International Monetary Fund

IMF (2013) 'Staff guidance note for public debt sustainability analysis in market-access countries', International Monetary Fund

Laskaridis, C. (2021) 'Debt sustainability: towards a history of theory, policy and measurement', PhD thesis, SOAS, University of London

Moore, T. (2025) 'Government's debt ceiling fears are overblown', *New Zealand Herald*, 21 May

Oduk, J. and C. Mithia (2024) 'Debt sustainability analysis: re-evaluating debt sustainability analyses in the context of hegemonic power and sovereign debt restructuring', *Development*, 67 (3), pp.220–32

Robertson, G. (2022) 'Budget 22: new fiscal rules to be put in place', media release, 3 May, https://www.beehive.govt.nz/release/budget-22-new-fiscal-rules-be-put-place

Treasury (2021) 'Treasury report: Fiscal indicators review', T2021/2416, May

Treasury (2022a) 'FEC briefing notes for BPS hearing', 11 April

Treasury (2022b) 'The Treasury's analysis and recommendations for fiscal rules', May

Treasury (2022c) 'Treasury report: Advice on fiscal rules', T2022/37, May

Treasury (2023a) 'Cabinet paper: Fiscal management: mini Budget, Budget 2024 and the fiscal sustainability programme', CAB-23-SUB-0490, December

Treasury (2023b) 'Treasury report: Budget policy statement 2024: options for further advice on your fiscal strategy', 21 December

Treasury (2023c) 'Treasury report: Initial decisions for your fiscal strategy', T2023/1992, November

Treasury (2024a) 'Treasury report: Approach to capital investments in Budget 2024', T2024/47, January

Treasury (2024b) 'Treasury report: Fiscal strategy for Budget 2024 – surplus target and operating allowances', T2024/475, March

Treasury (2025) *Te Ara Mokopuna: Treasury's 2025 long-term insights briefing*, Wellington: Treasury