The Treasury

Budget 2016 Information Release

Release Document July 2016

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[s18(c)(i)]	that the making available of the information requested would be contrary to the provisions of a specified enactment	
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Office of the Minister of Finance

Chair
CABINET

BUDGET 2016: WHAT WE'RE DOING AND HOW WE'RE ACHIEVING IT

Proposal

1. This paper seeks agreement to the overall strategy and process for Budget 2016, in order to deliver our economic, fiscal and social objectives. This will be achieved by building on the processes established at Budget 2015 to deliver improved public sector performance.

Executive Summary

2. Budget 2016 will continue to progress the Government's programme and priorities, which are:

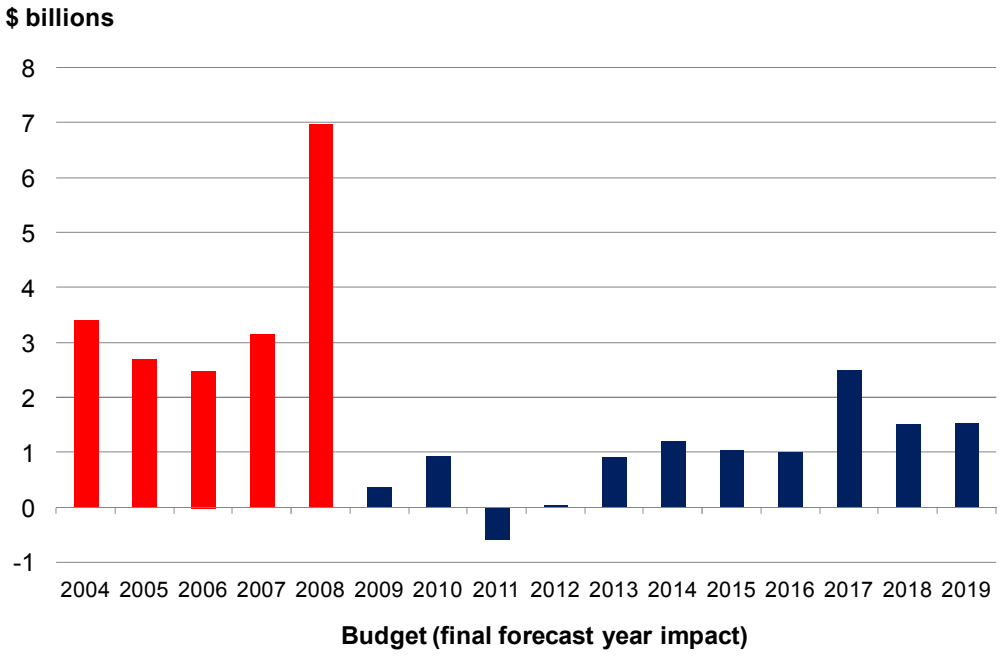
   - Responsibly managing the Government's finances
   - Building a more productive and competitive economy
   - Delivering better public services within tight financial constraints, and
   - Rebuilding Christchurch, our second-biggest city.

3. Budget 2016 will place emphasis on analysis and use of evidence to support investments that achieve results for New Zealanders. All agencies submitting initiatives for new funding will need to show they understand the impacts their current and proposed spending will have. I propose that we continue to use existing Ministerial groups focussed on the social sector, business growth and investment management to help pull together advice for Budget Ministers on the most effective use of our resources to further our Budget priorities.

Responsibly managing the Government's finances

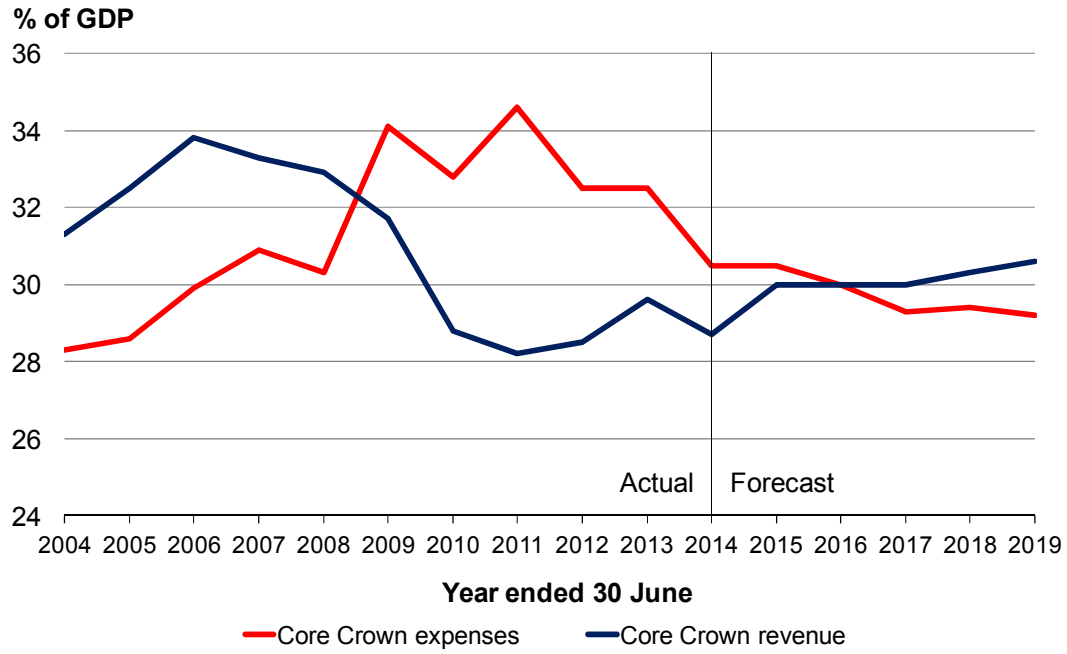
4. New Zealand's fiscal position has turned around significantly over our time in Government. Sustained expenditure control (Figure 1) has improved the operating balance before gains and losses from a deficit of $18.4 billion four years ago to broad balance now. As a result, net debt as a percentage of GDP is forecast to peak this year before falling to 22.9 per cent of GDP in 2018/19 and meeting our objective of net debt of 20 per cent of GDP by 2020. The 30 June 2015 year-end results due out in October will confirm whether we have achieved our intention to return the books to surplus by 2014/15.

Figure 1: Budget operating allowances



5. Lower new spending levels have now become normalised under this Government. Increasingly adopting tools that assess the effectiveness of expenditure and reprioritising towards higher value programmes will maintain this into the future. As a result, core Crown expenses are forecast to grow at a slower rate than the nominal economy, falling to 30 per cent of GDP in 2015/16 and below 30 per cent of GDP from 2016/17.

Figure 2: Core Crown expenses and revenue, Budget 2015 forecasts



6. We achieved this turnaround whilst still investing in results for New Zealanders. Budget 2015 included a $790 million package over four years to reduce child hardship, a $1.7 billion investment in public health services, and over $1 billion for early childhood, primary and secondary education. It also allocated $939 million of capital from the Future Investment Fund, including investments into new schools and classrooms, ultra-fast broadband, KiwiRail, Lincoln University, regional roads and urban cycleways.

Fiscal approach for Budget 2016

7. Since Treasury's Budget forecasts, the near term outlook has softened, reflecting a steeper fall in the terms of trade, a weaker labour market and reduced momentum in construction activity. The fall in dairy prices will directly reduce exporter incomes, and therefore nominal GDP growth. However, risks still remain skewed to the downside. There are global risks, particularly stemming from China and uncertainty about the future path of commodity prices. Domestically, there are risks from a further slowing of momentum in construction activity, subdued confidence and El Niño weather conditions.

8. There has been a significant depreciation of the New Zealand dollar and reduction in interest rates, with many economists expecting further easing in monetary policy. These are acting as shock absorbers for the economy. Monetary easing is helping to reduce the gap between New Zealand and world interest rates, taking pressure off the exchange rate. While lower interest and exchange rates will help support the economy, there is uncertainty about how businesses and households will respond to this stimulus.

9. The softer economic outlook is likely to result in lower tax revenue and higher welfare payments than previously expected. This will automatically provide some support for the economy, while weakening government finances. Depending on the size of the slowdown, this may result in a period of operating deficits.

10. Economic challenges since Budget 2015 mean we will need to be flexible if economic conditions deteriorate further, but at present do not justify a change in our planned operating and capital allowances. There needs to be a balance between supporting the economy to adjust to weaker dairy prices in the short term and returning debt to prudent levels over time. Allowances should only be increased as a response to any further deterioration in the economic outlook not as a response to cost pressures that should be managed from within baselines.

11. Now that we have returned the fiscal position to broad balance, we can help support the economy by allowing the fiscal position to fluctuate in response to cyclical shocks to the economy. I propose to formalise this approach in the 2016 Budget Policy Statement, by setting out a new framework of fiscal targets to help measure progress toward our medium-term goals while allowing more tolerance in response to shocks.

12. As set out in Budget 2015, the Government confirmed an operating allowance of $1 billion a year each for Budget 2015 and Budget 2016, before increasing to $2.5 billion in Budget 2017. A higher Budget operating allowance in Budget 2017 provides options around future income tax reductions should fiscal and economic conditions allow. The operating allowance for Budget 2018 has been set at $1.5 billion, rising thereafter at 2 per cent per Budget. These allowances were consistent with achieving our net debt target of 20 per cent by 2020.

13. The Government established the Future Investment Fund (FIF) to use the proceeds from the Government share offers to invest in priority new taxpayer assets. The FIF delivers on our commitment made prior to the 2011 election to use existing sources of funding on the Crown balance sheet to finance new capital investments from Budgets 2012 to 2016.

14. Approximately $3.9 billion of just under $4.7 billion in the FIF has been invested so far, with $726 million left following Budget 2015. Of this, approximately $430 million has been precommitted for investments in KiwiRail, the Asian Infrastructure Investment Bank, the National Biocontainment Laboratory,[33] [33] This leaves just under $300 million remaining in the FIF. However, I am aware of over $2 billion of capital pressures being signalled by agencies. Significant prioritisation and identification of savings from agency baselines will be required to meet such demand.

The Budget 2016 approach

15. In Budget 2016, I propose a renewed focus on evidence to justify expenditure. This will apply to all applications for new funding in Budget 2016 and over time in justifying existing activity before any new funding is accessed. There will be new funding available, but only where agencies can provide evidence that they understand a problem or opportunity and new funding will have a positive net impact. As a minimum, the standard requirement for agencies is that all initiatives should provide an assessment of the costs and benefits to set out the impacts they expect to achieve and the costs they will incur. The only exception to this is for cost pressure initiatives which should link back to the information provided with the Four Year Plan.

16. Agencies have fixed nominal departmental baselines, which do not increase with inflation. This means agencies are required to make productivity improvements in order to manage their cost pressures. There are cost pressures to be considered, but we should not be prepared to fund wage or other price increases without a clear understanding of the price we are paying, the quantity of outputs we are receiving, the standard of service we are getting and the impact this is generating for New Zealanders.

17. For Budget 2016, Treasury has developed a framework that enables all cost pressures to be assessed and analysed against each other, drawing on information submitted with Four Year Plans. Cost pressures from all Votes will be broken down using the same framework adopted in Budget 2015 (for the social sector):

    a. Demand and volume pressure

    b. Wages and price pressure

    c. Policy and other cost pressures.

18. I will take a report to the 2nd December State Sector Expenditure and Reform Committee (SEC) that will, based on the framework above, look at cost pressures and related funding arrangements across Government. The report will also give high level analysis of current and historic baselines and provide the choices available in relation to cost pressure funding in Budget 2016.

19. Through the Budget process, I expect all agencies to actively identify the lowest value items of expenditure that can be freed up in order to reprioritise towards expenditure that increases the results we can collectively achieve for New Zealanders. A number of reviews, such as the youth review, will help support this objective where we will be looking to free up lower value expenditure in order to support higher value activity for our priority population groups.

20. I am asking all Ministers to provide Finance Ministers with a letter detailing their Budget initiatives and strategic choices and trade-offs, including savings, in the votes they are responsible for. As in previous Budgets, looking into the value of what is produced with existing funding will be an important part of making sure that new activities receive funding.

21. Early engagement is important in setting out our expectations to departments on what we want them to focus on in their upcoming strategic planning process. I propose that the individual expectations each Minister sets for their department include the following collective expectations:

    a. We should increasingly take an investment approach to generating results for New Zealanders by measuring the outcomes we are looking to achieve and assessing which investments generate the best results.

    b. Departments should demonstrate that they know who their customers are, the characteristics of these customers, and the long-term costs (fiscal, economic and social) of providing services to these customers.

    c. Departments should consider themselves to be part of the wider system. They are expected to contribute towards outcomes outside of their core business and we will be looking for savings to be found in some areas to fund priorities in others.

    d. Departments should be innovative in thinking about how they will achieve their strategic objectives and manage their cost pressures. They should be able to clearly identify the key choices and trade-offs.

22. To support this and help assess the effectiveness of spending, I want to increasingly use experts both inside and outside of the public sector. In Budgets 2014 and 2015, Treasury used a capital investment panel made up of senior public sector officials to provide external expert opinion on capital proposals. The robustness of this process and the challenge it provided was useful to both agencies and Ministers. Treasury will continue this approach and is expanding this type of scrutiny to more expenditure proposals, such as the creation of a social investment panel for social sector initiatives (the terms of reference and membership will be discussed and confirmed at an upcoming Social Sector Priority Ministers meeting). This approach will include higher expectations on evidence for a proposal, and understanding of how a programme, project, service line or intervention's success will be monitored.

23. I propose that we continue to use the existing Ministerial groups focussed on the social sector, business growth and investment management to support Budget Ministers in making recommendations as to the most effective way for Budget 2016 to further our priorities.

Building a more productive and competitive economy

24. The Business Growth Agenda (BGA) sets out the actions that we are taking to strengthen our economy, improve productivity and competition, and create jobs. The BGA is designed to ensure that the business community and the public can see tangible progress in each of the six BGA areas which support business growth and success.

25. New Zealand has recovered well from the Global Financial Crisis and has laid the foundations to move forward. Many of our challenges (for instance, rising house prices and environmental constraints) are a reflection of our success. To continue to support growth we need to address our challenges and provide businesses with the confidence they need to invest and to provide the platform for sustained growth.

26. Despite our strong recent performance, a substantial income gap remains between us and many other developed countries. Much of this gap appears to be because New Zealand is uniquely small and remote from our historic markets.

27. We have spent some time thinking about what we need to succeed. This year's refreshed BGA report will outline our vision of what a successful economy will look like by 2030. By 2030 we want:

    a. A market based economy that reflects Kiwi attributes – agile, resourceful, innovative and world-beating.

    b. Our businesses add greater value to their goods and services – attracting a premium from our natural resources, intellectual edge and industry know-how.

    c. We are more internationally connected to reduce the impacts of distance, and seen as a real hub of talent and ideas for the Asia-Pacific region.

    d. An economy where all regions and our people have the opportunity to grow and prosper.

    e. We are one of the most highly-skilled countries in the world, with ambitious global leaders who make the best of our diversity of talents and ideas.

28. An economy like this would grow our productivity and our incomes, and deliver real and ongoing improvements in the quality of life for all New Zealanders. To be successful, this requires action across a range of areas:

    a. Export Markets – Creating businesses that are internationally-connected and able to seize opportunities for New Zealand in an increasingly Asia-Pacific centred world.

    b. Innovation – Developing New Zealand as a hub for high-value, knowledge-intensive businesses conducting more R&D to lift innovation.

    c. Investment – Attracting high-quality investment into every part of New Zealand – including our regional and Māori businesses.

    d. Infrastructure – Providing the right infrastructure at the right time to support future investment, growth, and quality of life.

e. Skills – Equipping all our people with the skills to participate and succeed in our 21st century economy and society.

f. Natural Resources – Improving the productivity of our resource-related industries while reducing their environmental impact.

29. I propose that we continue to use these workstreams as an organising framework for initiatives aimed at supporting business growth in the Budget process. The BGA stream will be consistent with efforts made in the wider Budget process (in particular the social sector process) to enable Budget Ministers to make necessary trade-offs across the whole of the Budget package. This includes that all initiatives will require an assessment of costs and benefits to be undertaken as well as ensuring that savings and reprioritisation are identified as detailed above.

30. In addition, I propose some specific features for BGA initiatives:

a. the BGA vision laid out above, which is a new feature of the 2015 BGA refresh, will be used across the sector to catalyse action and inform priorities;

b. as with Budget 2015, existing Ministerial groups for each BGA workstream will indicate their workstream priorities;

c. building on Budget 2015, Treasury will work with the relevant Chief Executive Groups to advise the different BGA Ministerial Groups;

d. BGA ministers will be supported in developing a package of initiatives that promotes the whole BGA vision by an officials governance group that looks across the BGA. This group comprises Chief Executives of the main economic agencies; Treasury, MBIE, MPI, MFE, MFAT and NZTE.

31. I propose that, like in previous Budgets, Associate Minister of Finance (Hon Steven Joyce) is the lead on developing the BGA package.

Delivering better public services within tight financial constraints

32. We have set the public service ten challenging results to achieve, and the Better Public Services programme continues to make measurable progress toward solving difficult social problems. For example, we are making good progress with an increase in the number of 18 year olds achieving NCEA Level 2 as well as continuing to reduce long-term welfare dependency. In February, we made these results even more ambitious by extending the welfare target, further reducing the crime target and increasing the target on the workforce skills of young adults. Looking forward, the challenge is to lock in, then accelerate these gains and continue improving the lives of New Zealanders.

33. Budget 2016 will continue to embed a social investment system that better uses information about the long-term drivers of poor outcomes and cost to put the focus on achieving better impacts for customers. We have been employing this approach for several years in areas such as welfare and introducing new delivery models like Whānau Ora, and are now testing the expansion of this approach in areas like the justice sector and social housing.

34. I have asked Social Sector Priority Ministers (SSPM) to prepare collective advice to Budget Ministers on social sector investment and reprioritisation options for Budget 2016. SSPM have decided that the priority population focus for social investment will be youth aged 15-24 and on families/whānau with children aged 0-5 for whom at least two of the following risk factors apply:

    a. Child Youth and Family finding of abuse or neglect

    b. Caregiver with a Corrections' history

    c. Long-term benefit receipt

    d. Mother has no formal qualifications

35. An enhanced and more comprehensive profile is currently being developed in the Integrated Data Infrastructure by the end of September. The new profile will include: improved definitions of risk factors; additional indicators of family structure; indicators of success in the early years such as use of preventive health services, and health risk factors such as maternal smoking; an indicator of ECE participation; and indicators of transience.

36. Review work is already underway to consider savings and investment options for youth (15-24 years old) and options will feed into the social investment track Budget process. SSPM will also consider how findings from other relevant existing reviews, such as the CYF Expert Panel, can best fit with the Budget 2016 process and priority group options.

37. There is funding available for investment where there is evidence of good return on investment, the impact of relevant base spend is understood, and impacts will be tracked over time to inform scale-up or cease decisions. To improve the quality of discussions about expected impact, Treasury has provided a cost benefit analysis tool, CBAx that agencies will be required to use for all non-cost pressure social sector proposals. The outcome will be combined with other considerations (e.g. strategic alignment) to inform prioritisation advice. I do not expect to have perfect information about future impacts for all proposals, but this tool will help improve the quality and comparability of prioritisation advice to Ministers, and help officials identify information strengths and gaps to inform future system development. Treasury will support agencies in their use of CBAx and review the results.

38. Social investment is ultimately about improving outcomes for people, and decisions should consider opportunities to adapt services and delivery, drawing on advice from experts on the ground. Place-based approaches, including medium term options and transitional arrangements for Budget 2016, are being discussed by Social Sector Ministers and any decisions will be integrated into the Budget process.

39. I expect that the priority populations identified above will be the primary populations targeted in any placed-based approaches for Budget 2016. Approaches need to be based around the needs of local populations, with all agencies and local communities working together, to deliver collective impact on agreed outcomes through results-based and adaptive contracting and social

investment principles such as using data to measure the impact of the investment need to be embedded into these approaches.

40. We need to provide Ministers and agencies with the tools to change the way some services are delivered to particular communities. New tools for local funding and accountability will be required to enable the evolution of a number of initiatives that have different agency interests including Social Sector Trials, Children's Teams and integration with Whānau Ora. I propose that Associate Minister of Finance (Hon Paula Bennett) work with Ministers to develop and test these tools.

41. I have asked Treasury to support SSPM to prepare advice for Budget Ministers. This will include the convening of a social investment panel (including Sir Peter Gluckman and senior officials) to comment on proposals. The Social Sector Board agencies will provide advice on options for the population focus groups, and support their own portfolio Ministers.

42. Ministers have also agreed that Treasury will collate an initial high-level overview of likely savings and investment opportunities for November 'triage' discussions. This will allow Ministers to signal which options are of interest and where agencies should focus effort on refining proposals for formal submission and assessment from December. This process will pick up findings from the youth and 0-5 year olds work, and Ministers and agencies should be prepared to signal other proposals to Treasury by the end of October.

System package

43. A number of initiatives were identified through the Budget 2015 process that would have broad benefits across agencies and where progress was stalling due to the lack of a funding agreement between agencies e.g. voluntary pooling or cost recovery.

44. It was agreed at Budget 2015 that these initiatives would be progressed through mandatory baseline contributions from all departments as well as three large Crown entities that stand to benefit from the initiatives: New Zealand Transport Agency, Accident Compensation Corporation and Tertiary Education Commission.

45. It is likely that similar initiatives will be identified that have broader system benefits that contribute to objectives that cross over individual agency boundaries. Where these generate savings for individual agencies it is appropriate that they should contribute to the cost of these initiatives through mandatory baseline contributions, where voluntary pooled funding options have failed. Where savings are not generated then Crown funding would be appropriate.

46. Initiatives will still need to be assessed with the same amount of rigour as any other initiative: that it will achieve results for New Zealanders and cannot be managed from within current resources.

47. Treasury is currently identifying initiatives that should be considered through this process. We will need to consider what funding mechanism is appropriate once we have assessed the quality of initiatives and the impacts they will have.

Improving the efficiency of capital expenditure

48. As noted above, the Future Investment Fund delivers on our commitment to use existing sources of funding on the Crown balance sheet to finance new capital investments from Budgets 2012 to 2016. Approximately $3.9 billion of the $4.7 billion in the Fund has been invested so far and approximately $430 million has been precommitted for Budget 2016, leaving approximately $300 million.

49. Treasury will again convene the Capital Investment Panel to review and evaluate capital initiatives from a "whole of government" perspective. The Panel will assess the relative value of initiatives, to ascertain if investment decisions reflect good use of resources (from both baseline and new funding), and to advise on the distribution of new funding across government. The Panel will convene in November and again in February to consider the portfolio of government investments and to make recommendations on a package of investments for Budget 2016.

50. By December, the first tranche of eight investment-intensive agencies will produce Long Term Investment Plans (LTIPs) with at least a 10 year horizon. The LTIP's primary purpose is to explain how each agency's long term capital investment intentions relate to their strategies and service delivery requirements. The quality of the LTIP is taken into account in the agency's investor confidence rating (ICR). The ICR assessment process will consider how well the plan reveals and evaluates choices for meeting an agency's strategic intentions and making the most effective and efficient use of balance sheet resource, as well as the expected impact of investment intentions on the agency's financial, asset and service performance. A key factor in the assessment is the extent to which the agency considered non-asset approaches to manage demand back to more affordable levels.

51. Treasury will consolidate insights and information on the performance of capital baselines provided through the LTIPs and Four Year Plans and provide advice on resultant savings or performance improvement opportunities to the Investment Panel. In turn, the Panel will use this information to inform its portfolio-level advice to Treasury and Investment Ministers on how investment priorities can be funded from baselines.

Timeline

30 October	Cost pressure information for all agencies is due. Draft initiatives in the social sector are due.
November	Advice to SSPM and Budget Ministers on draft social sector initiatives.
2 December	SEC meeting to discuss report on cost pressures and related funding arrangements across Government.
4 December	Budget initiative template and supporting information due for all initiatives. Responsible Minister sends letter to Minister of Finance detailing their Budget proposals.
9 December	Final Four Year Plans due.
Mid-December	Budget technical guidance released including an interim Budget 2016 timetable. This timetable will include due dates for the March Baseline Update, financial recommendations, Estimates etc but cannot be finalised until Budget day is confirmed.
Pre Christmas	Treasury provide Finance Ministers with high level analysis of the pressures against the allowance and an assessment of the quality of information at this point.
Late January	Treasury assess Budget initiatives
February	Budget day confirmed and final Budget 2016 timetable released
February	Social Investment Panel and Investment Panel meet to consider social sector initiatives and capital initiatives respectively. They provide advice to Treasury and the respective Ministerial groupings.
February-March	Ministerial groups meet and discuss packages of initiatives to present to Budget Ministers (Prime Minister and Finance Ministers).
Late March	Budget Ministers agree final Budget package
April	Cabinet confirm final Budget package

Consultation

52. This paper was prepared by Treasury.

53. Treasury will provide guidance and brief agencies about the Budget 2016 expectations and processes. Treasury will publicly release tools, such as the CBAx spreadsheet model and database that support agencies in undertaking return on investment analysis. Public release will provide transparency and enable use of the resources more widely.

Recommended Action

I recommend that Cabinet:

1. **note** the Government's Budget priorities are responsibly managing the Government's finances, building a more productive and competitive economy, delivering better public services within tight financial constraints, and rebuilding Christchurch;

2. **note** that the Government's books have turned around significantly over the last seven years and are heading in the right direction;

3. **note** that progress has come from defining results, designating a Minister and Chief Executive responsible for achieving each of them and reprioritising resources accordingly;

All Agency Budget Initiatives

4. **agree** that there will be a focus on agencies working as part of a wider system and on whether expenditure delivers results, both in baselines and new spending, supported by data and information;

5. **agree** that all initiatives will require an assessment of costs and benefits to be undertaken, except those that are classified as cost pressures as part of the Four Year Plan;

6. **direct** agencies to submit final Budget initiatives to Treasury by 4 December;

7. **invite** responsible Ministers to send a letter to the Finance Ministers detailing their Budget submission including a list of initiatives and savings options;

8. **note** that detailed Budget guidance will be released on 17 September;

9. **note** that Treasury will provide advice to Budget Ministers on a package of initiatives and trade-offs across all initiatives, using common assessment frameworks where possible;

All Agency Cost Pressures

10. **direct** agencies to submit cost pressures information, as requested in the Four Year Plan guidance to be submitted by 30 October, to allow comparison of cost pressures across agencies;

11. **note** there will be a report to SEC on 2 December that details cost pressures and related funding arrangements across Government;

12. **note** that we continue to expect that cost pressures will be funded from within baselines;

Social Investment

13. **note** that vulnerable children and youth in age groups 0-5 and 15-24 are the priority populations for Budget 2016;

14. **agree** that the CBAx tool will be applied to all social sector initiatives that are not cost pressures identified through the Four Year Plan process;

15. **note** that a Social Investment Panel will be established and that the terms of reference and membership will be discussed at an upcoming Social Sector Priority Ministers meeting;

16. **note** that the Social Investment Panel and Treasury will provide advice to Social Sector Priority Ministers on a recommended package of initiatives;

17. **invite** Social Sector Priority Ministers to provide advice to Budget Ministers on a recommended social sector package by late March;

18. **agree** that Associate Minister of Finance (Hon Paula Bennett) will work with Ministers to develop local funding and accountability tools for social investment;

Business Growth Agenda

19. **agree** that the BGA be used as an organising structure for Budget 2016;

20. **note** that the BGA vision, which is a new feature of the 2015 BGA refresh, will be used across the sector to catalyse action and inform priorities;

21. **note** that, for clarity, all BGA initiatives will be required to provide an assessment of the costs and benefits as outlined in recommendation five;

22. **agree** that Associate Minister of Finance (Hon Steven Joyce) will be the lead Minister for the BGA in Budget 2016;

Capital Initiatives

23. **note** that the Future Investment Fund (FIF) comes to an end in Budget 2016;

24. **note** that to stay within the limit of the FIF will require strict prioritisation and savings from agency baselines;

25. **note** the intention to use the review of Long Term Investment Plans to confirm the sustainability, effectiveness and efficiency of agency capital baselines and balance sheets;

26. **note** that the Capital Investment Panel will meet in November and February to consider and provide advice on the best value portfolio of investments;

27. **agree** that Investment Ministers will consider the fiscal pressures within the portfolio of investments and make recommendations about the government investment portfolio.

Hon Bill English
Minister of Finance

Date:

ANNEX ONE

DRAFT: BUDGET SECRET

Treasury:3287504v5