# The Treasury

## Budget 2018 Information Release

## Release Document August 2018

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| | | |
|---|---|---|
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THE TREASURY
Kaitohutohu Kaupapa Rawa

# Treasury Report: Establishing the Provincial Growth Fund

| Date: | 22 November 2017 | Report No: | T2017/2554 |
|---|---|---|---|
| | | File Number: | SH-11-1-2 |

## Action Sought

| | Action Sought | Deadline |
|---|---|---|
| Minister of Finance<br>(Hon Grant Robertson) | **Agree** to arrange a meeting with the Minister for Regional Economic Development to discuss how the Provincial Growth Fund will be funded<br><br>**Forward** this report to the Minister for Regional Economic Development. | none |
| Associate Minister of Finance<br>(Hon Dr David Clark) | **Note** the implications of different funding options for the Provincial Growth Fund. | none |

## Contact for Telephone Discussion (if required)

| Name | Position | Telephone | | 1st Contact |
|---|---|---|---|---|
| Darian Woods | Senior Analyst | [39] | N/A<br>(mob) | ✓ |
| Matthew Gilbert | Manager - Business Growth & Innovation | [39] | [23]<br>(mob) | |

## Actions for the Minister's Office Staff (if required)

**Return** the signed report to Treasury.

**Forward** report to the Minister for Regional Economic Development.

| Note any feedback on the quality of the report | |
|---|---|

# **Treasury Report:** Establishing the Provincial Growth Fund

## Purpose of Report

1. This report sets out officials' understanding of the funding options available for the Provincial Growth Fund (PGF). It describes the implications of different funding arrangements, and outlines suggested principles for the Fund.

## Context

2. The Coalition Agreement between New Zealand Labour Party and New Zealand First states:

   *…New Zealand First has a number of priorities to progress which Labour will support alongside its policy programme. These include the following goals:*

   *A $1 billion per Regional Development (Provincial Growth) Fund, including:*

   - *Significant investment in regional rail.*
   - *Planting 100 million trees per year in a Billion Trees Planting Programme.*
   - *Commissioning a feasibility study on the options for moving the Ports of Auckland, including giving Northport serious consideration.*
   - *Other large-scale capital projects.*

3. The Ministry of Business, Innovation and Employment (MBIE) and the Ministry for Primary Industries (MPI) is working alongside the Treasury, the Ministry of Transport and Te Puni Kōkiri to advise on the design of this fund.

4. How the PGF is funded by the Government, including what funding is drawn from the capital allowance, will influence the nature of the PGF and constrain funding choices in other sectors.

5. The capital allowances over the next four Budgets before any contributions to the PGF are:

**Table 1: Capital allowance**

| ($ million) | **Budget 2018** | **Budget 2019** | **Budget 2020** | **Budget 2021** |
|---|---|---|---|---|
| Capital Allowance | 3,400 | 3,400 | 3,100 | 2,700 |
| Precommitments | (700) | (700) | (400) | - |
| **Remaining Capital Allowance** | **2,700** | **2,700** | **2,700** | **2,700** |

[33]

7. There is $2.7 billion per Budget remaining in the capital allowance to meet these capital pressures, and to meet other commitments set out in the Fiscal Plan, and the Coalition and Confidence and Supply agreements.

8. The higher the contributions from allowances to the PGF, the less available in each Budget to meet these pressures and commitments.

## Options for funding the Provincial Growth Fund

9. Three funding options are presented for discussion:

   **Option 1: $975m per annum set aside from the capital allowance and $25m per annum set aside from the operating allowance.** The $25m per annum from the operating allowance is based on discussions between the Minister of Finance and the Treasury where this was raised as a potential source.

   **Option 2: Setting aside a portion of $1 billion per annum through the capital allowance, with the remainder funded through:**

   i **Identifying current expenditure**. Identification of expenditure currently committed would serve to highlight regional economic development. For example, the Rural Broadband Initiative and Mobile Blackspot Fund.
   ii **Identifying future expenditure that relates to regional economic development**. There will be future Budget decisions that relate to the PGF's objectives. One example might be any new capital injection for KiwiRail.
   iii **Repurposing regionally related funds**. This means taking the current appropriations for funds related to regional economic development and incorporating these into the PGF. For example, funding mid-sized tourism facilities, such as carparks, would be met through the PGF instead of the Tourism Infrastructure Fund.

   Two sub-options are presented here: one defining regional economic development narrowly (i.e., relating to infrastructure, enterprise and jobs only – **Option 2a**), and a second defining regional economic development more broadly to include Health and Education (**Option 2b**).

   **Option 3: Funding the full $1 billion per annum through identification and repurposing (as in Option 2) plus local government and private sector co-funding.**

10. Table 2 sets out these funding options in more detail. All options are funded within the Government's Fiscal Strategy. As such, they have no impact on net debt projections.

11. The table preliminarily identifies a number of ways to meet the PGF's objectives without setting aside the capital allowance. Among projects that contribute to government-wide capital pressures, there are many that overlap with regional investment. This is our initial advice and needs to be tested with other agencies. Further work will be required to determine the exact amount of identified and repurposed funding.

12. The key trade-off is between the impact on the capital allowance and flexibility for ministers around decision rights for funding within the PGF – the higher the amount of new funding the greater the decision rights are around how PGF funding is spent.

13. For options other than Option 1, much of the funding would already be tagged for particular areas or types of infrastructure. This would reduce the ability of the PGF to add new activity to regions to achieve its objectives. This would mean that spending from other portfolios may be driven and announced by the Minister for Regional

Economic Development. Officials will need to provide advice on how decision rights around any repurposed funding can be aligned to the PGF.

14. **The Treasury's preference is for options that limit new funding from the capital allowance.** This is due to the level of pressure on the capital allowance overall and the availability of options to advance PGF objectives through existing funding. It also encourages embedding a regional lens to decisions across central government and leveraging local partnerships.

**Table 2: Initial advice showing illustrations of options to fund the Provincial Growth Fund**

More flexibility for PGF, less funding across government

| Option | Value of initiatives potentially suitable for identification | Value of regional funds potentially suitable for repurposing | Impact on capital allowance | Comment |
|---|---|---|---|---|
| **Option 1: $975m per annum set aside from the capital allowance and $25m per annum set aside from the operating allowance** | - | - | **$975m per annum** | This would mean a remaining capital allowance of $1.725 billion in each Budget.<br><br>This would require challenging decisions prioritising hospital replacements, implementing the Defence White Paper, KiwiRail support, metro rail pressures, regional roads, meeting classroom roll growth, and meeting capacity constraints in prisons.<br><br>This option gives greater flexibility for spending inside the Provincial Growth Fund. |
| **Option 2a: Setting aside a portion of $1 billion per annum through the capital allowance, with the remainder funded through identification and repurposing taking with a <u>narrower definition of regional economic development</u>** | **$520m - $890m per annum**, comprising:<br><br>1. **$130m - $200m per annum from existing funding:** Rural Broadband Initiative and Mobile Blackspot fund, regional transport funding, Regional Research Institutes, and legacy funding in Crown Irrigation Investments Limited; and<br><br>**2. $390m - $690m per annum** in potential future capital expenditure relating to KiwiRail based on prior Budgets, Nelson Southern Link, doubling funding range of regional transport funding, Manawatū Gorge, and Kaikōura rail and road | **$95m - $150m per annum** from Regional Growth Programme expenditure, Tourism Infrastructure Fund, Primary Growth Partnership, Afforestation Grants, and regional Ministry of Arts, Culture and Heritage funds | **Up to an estimated $395m per annum** (based on lower end of the value of potential initiatives available for identification and repurposing)<br><br>Identification of future capital spending would still need to be funded through the capital allowance (as is also the case for options 2b and 3). | Identifying regional components of infrastructure as part of the Provincial Growth Fund would allow prioritisation of capital needs across the government's infrastructure pressures.<br><br>If Ministers repurposed regionally related funds such as the Tourism Infrastructure Fund, they may wish to consider how the PGF's criteria can align with those funds' objectives. |
| **Option 2b: Setting aside a portion of $1 billion per annum through the capital allowance, with the remainder funded through identification and repurposing taking with a <u>broader definition of regional economic development</u>** | **Total: $1,290m per annum**, comprising:<br><br>As above, plus:<br><br>**$730m per annum** in hospitals outside of Auckland, Wellington and Christchurch<br><br>**At least $40m per annum** on new schools and expansions outside of Auckland, Wellington and Christchurch | **$95m - $150m per annum**, comprising:<br><br>As above. | **Potentially $0m** (based on available options for potential identification and repurposing) | Identifying regional components of infrastructure, as well as schools and hospitals as part of the Provincial Growth Fund would allow greater prioritisation of capital needs across government. It would have the implication that the PGF would have an increased focus on Health and Education initiatives. |
| **Option 3: Funding the full $1 billion per annum through identification and repurposing plus local government and private sector co-funding** | As above. | As above.<br><br>Considering private sector and local co-funding can reduce the need to identify and repurpose.<br><br>Any savings from other central government spending unrelated to regional economic development can also reduce pressure. | **Nil** | This option encourages embedding a regional lens to decisions across central government, leveraging local partnerships, and allows increased flexibility to address capital pressures.<br><br>The capital allowance after pre-commitments would stay at $2.7 billion per annum, allowing funding decisions to take a wider view when prioritising capital projects. |

Less flexibility for PGF, more funding across government

## Wider considerations

15. Different funding arrangements will have different implications for decision rights among Ministers. Decision rights for existing mechanisms can be modified if required.

16. Throughout these options there are choices about the mechanism by which the PGF is administrated. Options include a notional fund without a formal appropriation, a tagged contingency in Budget, a range of appropriations, or a single appropriation. This paper does not go into the details of this question: the funding source and objectives of the PGF can be agreed first to then inform the best way to structure this fund.

17. Spending decisions may have consequential implications for capital charge (currently set at 6 percent) and depreciation. This may affect the final balance of operating and capital spending. More advice will be provided once the investment profile is clearer. It is expected any capital charge would be met within the $1 billion per annum.

18. There are also choices around the mix of funding drawn from the operating and capital allowances.

19. These details can be worked through once the overall funding approach, presented in this paper, is decided.

*Principles for the establishment of the PGF*

20. The Treasury's view is that the following considerations are also important in the establishment of the PGF:[1]

    1) Its objectives are linked to the Government's broader economic strategy

    2) There is clarity about objectives of the overall fund, region's aspirations and goals for individual projects

    3) That a system is in place to measure, report and evaluate progress towards its objectives

    4) Existing processes are used as much as possible, and

    5) The Government's goals in other areas are also advanced where possible.

*The Government's economic strategy*

21. The Government's economic strategy is still under development but will reflect the fact that wellbeing is determined by sustainable, productive and inclusive growth. This means the Government will be focused on driving productivity growth in the economy to enable environmentally sustainable growth that is delivering higher wellbeing for all New Zealanders.

22. Examples of areas where the PGF could advance the Government's goals in other areas include Net Zero Emissions Economy by 2050, increasing spending on research and development to 2 percent of GDP over ten years, He kai kei aku ringa, and improving water quality.

23. The way this Fund is established should consider how to appropriately balance the different dimensions of the economic strategy. Therefore, a careful consideration of

[1] MBIE and MPI are leading work on the design of the Provincial Growth Fund in collaboration with TPK and MoT and input from other agencies.

which agencies or boards are advising, assessing, prioritising, governing and delivering projects in the PGF will be important, along with the incentives they face.

*Using existing processes*

24. In our view the PGF could make use of existing structures and processes. The National Infrastructure Advisory Board, Crown Infrastructure Partners, the National Land Transport Fund, and annual Budgets should all be seriously considered as vehicles for delivering the $1 billion per annum investment in regional economies.

25. Minister Jones' joint responsibilities for Infrastructure and Regional Economic Development present the opportunity for the Thirty Year Infrastructure Plan and National Infrastructure Advisory Board (NIAB) – both of which are in the Minister's portfolio – to provide governance and advisory support for the PGF's infrastructure projects.

26. The Minister could find NIAB useful in this regard. The Board has connections across the infrastructure sector and connections in some of the regions that the Minister has highlighted for focus, particularly Te Tai Tokerau and Tairāwhiti. The NIAB Chair John Rae is also Chair of Ngāpuhi Asset Holdings and Chair of the Gisborne region's economic development agency, Activate Tairāwhiti.

## Next Steps

27. We recommend you forward this report to the Minister for Regional Development and meet with him to discuss the funding model for the PGF.

## Recommended Action

We recommend that you:

a **Agree** to a meeting with the Minister for Regional Economic Development to agree how the Provincial Growth Fund will be funded

*Agree/disagree.*

b **Forward** this report to the Minister for Regional Economic Development.

*Agree/disagree.*

Matthew Gilbert
**Manager - Business Growth & Innovation**

Hon Grant Robertson
**Minister of Finance**

Hon Dr David Clark
**Associate Minister of Finance**