

The Treasury

Budget 2018 Information Release

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Treasury Report: Baseline Reprioritisation Process

Date:	23 November 2017	Report No:	T2017/2576
		File Number:	BM-2-1-2018

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree or amend the text of the attached draft letter, and have sent to all Ministers. Indicate whether you want Treasury to set a savings target.	As soon as possible
Associate Minister of Finance (Hon Dr David Clark)	Read for your meeting with Treasury on Tuesday 28 November	9.40am, Tuesday 28 November
Associate Minister of Finance (Hon David Parker)	To note	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Robert Barton	Senior Analyst	[39]	N/A (mob) ✓
John Marney	Team Leader, Budget & Financial Design	[39]	N/A (mob)

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

Amend the draft letter as required, **obtain** Minister of Finance's signature, and **arrange delivery** to all Ministers.

Return the signed report and a copy of the signed letter to Treasury by 28 November.

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Treasury Report: Baseline Reprioritisation Process

Executive Summary

Following your request to examine some past spending decisions, we have set up an internal Treasury process to identify low value spending and reprioritisation options. We recommend a two stage process for baseline reprioritisation: Stage One focused on savings from policy realignment for Budget 2018, with a post-budget Stage Two addressing policy settings which drive significant costs.

Externally, we recommend that you should write to your Ministerial colleagues requiring them and their agencies to undertake a review of current spending, and to report to you by 26 January 2018 identifying:

- immediate savings for Budget 18, along with discrete savings options that could be progressed in future budgets; and
- core policy settings driving material costs, which could potentially be the focus of a more in-depth review process in Stage Two.

For Stage Two, we recommend selecting a few major sectors or Votes from which to investigate the policy settings where a real effort over the next six to eighteen months should be directed. Information provided from Stage One and from agencies' cost pressures bids (due this December) will help in selecting these.

One objective of Stage Two would be to free up some fiscal headroom so that Budgets 2019 onwards can be better aligned with a living standards approach. We recommend that work on Stage Two should begin as soon as Budget 18 is settled (likely in April).

Recommended Action

We recommend that you:

- a. **note** the two-stage process for baseline reprioritisation, and that Treasury has started an internal process to identify possible immediate savings for Budget 2018;
- b. **agree** to sign and send a letter to all appropriation Ministers (draft attached for your consideration)

Agree/disagree.

- c. **Indicate** whether you would like Treasury to set a percentage savings target for agencies (see paragraphs 12 to 15)

Yes/no

John Marney
Team Leader, Budget & Financial Design

Hon Grant Robertson
Minister of Finance

Hon Dr David Clark
Associate Minister of Finance

Treasury Report: Baseline Reprioritisation Process

Purpose of Report

1. This report outlines the process we intend to follow to address the issues raised by Finance Ministers last week. It concentrates on the immediate term process for finding savings from realigning policies in time for Budget 2018. We also outline a way forward to Budget 2019 and beyond.

Background

2. In discussing options for reprioritisation of existing spending, you indicated that Ministers envisage a two stage process:
 - a. Immediate savings that can be made through Budget 2018. These should especially come from identifying activities that are not aligned with Government priorities or which are of low value;
 - b. Longer term savings through addressing a rebalancing of sectoral spending and core policy settings which drive costs. This is to be an ongoing process over future budget cycles, informed by Government priorities and a living standards approach.
3. You also indicated that you were looking to Treasury to provide an independent stream of advice about short-term savings and longer-term reprioritisation options.
4. Treasury will be able to identify some areas of low-value spending and reprioritisation options. However, the real gains are likely to come from Ministers working with their agencies, examining their baselines and key policy settings. Therefore, this report proposes that Ministers and agencies should be given the opportunity to drive this work, with Treasury officials co-ordinating the process and providing an independent source of advice to Finance Ministers.
5. Throughout this process, Ministers will have to make the key decisions. While officials can advise, Ministers are the only ones who can balance the Government's policy and fiscal priorities. Extracting savings from baselines is likely to require a strong and sustained push from Finance Ministers, and through you, appropriation Ministers. Therefore, while it is sensible to cast a wide net initially (for Budget 18), you may want to narrow the focus for the longer-term to some core sectors where there is scope for material savings.
6. We are therefore recommending a two stage process, the first of which has two parts:
 - a. Stage One in time for Budget 2018, containing two parts:
 - i an initial Treasury scan of areas to target (including information from cost pressures bids);
 - ii a process led by appropriation Ministers to examine agency baselines for alignment with Government priorities, to report at the end of January
 - b. Stage Two, which will be post Budget 2018, will select a few sectors or agencies for a more in-depth review of core policy settings driving material costs.

7. Stage One is primarily about policy and priority alignment with the new Government's priorities, although low value spending may also be identified. As you have indicated, now is the best opportunity the Government will have to achieve reprioritisation from policy realignment. Stage Two will be a harder and longer process which will require big and difficult policy trade-offs, but at the same time is where the really significant savings can be realised.

Treasury actions

8. Following your request to examine some past spending decisions, we have set up an internal Treasury process to identify low value spending and reprioritisation options. Amongst other things, we have asked our analysts to consider discretionary spending decisions in previous Budgets which Treasury either did not support or which we considered provided low value for money. On its own, however, this would be quite a limited (and difficult) exercise, and we doubt it will yield all that much by way of concrete savings. Discretionary spending in recent Budgets has been fairly limited, once cost pressures are excluded. Advice provided during the budget process also tends to be contextual, reflecting the priorities of the government of the time and an iterative dialogue with Ministers. We have therefore asked our analysts to look more widely, with a view to providing advice on low-value and discretionary spending in general (irrespective of when decisions were made) and core policy settings that drive costs.
9. Off the back of this process, we will provide you with initial Treasury advice in the week of 4 December (to be confirmed) about:
 - a. where material savings can feasibly be made within current baselines through Budget 2018 (Stage One);
 - b. options for savings beyond Budget 2018 (Stage Two). Advice on this will be preliminary as we will also need to consider the findings from the Ministerial and agency led process (see below), along with information on cost pressures which we will receive through the main Budget 18 process.

Agency-led process

10. The Budget 18 and Fiscal Strategy Cabinet paper has already signalled a focus on baseline reprioritisation and the Minister of Finance's strong expectation that Ministers work with their agencies to identify savings to help deliver the Government's agenda over the next three years, including for Budget 2018. We suggest the following two stage approach.

Stage One: Initial scan of all agencies

11. In the first instance, we recommend that the Minister of Finance should write to your Ministerial colleagues requiring them to undertake a review of current spending, in consultation with their chief executive. This should cover both departmental and non-departmental expenditure and apply to all agencies – including Crown entities funded by taxpayers. We recommend that you ask Ministers to write back to you by 26 January 2018 setting out:
 - immediate savings for Budget 18 arising from realignment to Government priorities, along with discrete savings options that could be progressed in future budgets;

- advice about core policy settings driving material costs, which could potentially be the focus of a more in-depth review process.
12. This approach should give those Ministers ownership of the process and will impress upon chief executives and their agencies the seriousness of the exercise. Attached to this report is a suggested draft letter for your consideration.
 13. Treasury will also be in touch with agency chief executives to provide further advice on the Government's expectations for a rebalancing of spending priorities, the release of savings, and the process for meeting these expectations. As part of that guidance, we seek your views as to whether a savings target should be set.

To Target or not?

14. Setting a target has the advantage of providing focus for agencies, indicates the seriousness of the Government's intent, and provides Treasury with leverage if the target is not being achieved. On the downside however, a target incentivises agencies to focus on finding (or fighting) the savings target, rather than on seriously considering the current policy mix, and risks cutting effective services in order to meet the target. Any target is arbitrary and all agencies start from different initial positions, with the target set being too easy for some and too hard for others.
15. On balance therefore we lean against setting a specific percentage target, and prefer to leave Ministers and chief executives with the room to come up with savings from their own investigations of their baselines. However, if you think that a set target would generate a better focus, then we would be happy to set one on your behalf. (We would likely set one at 2% but exempting the very smallest agencies.)
16. Regardless of whether a target is set, we will emphasise the point made in the Cabinet Budget Strategy paper that savings identified early in the process for Budget 2018 will be taken into account in future budget rounds.
17. While Stage One can initially be conducted by requesting Ministers to work with their chief executives, it will not be practical for you to meet with every Minister on their findings. The exercise will therefore probably end up in a smaller number of more serious discussions between Finance Ministers and a few individual spending Ministers. Once responses have been received, we will provide you with advice about where to focus your bilateral discussions.
18. Whereas the main objective from Stage One is to get savings from deprioritised and low value policies, a second objective is to identify broader policy settings which drive costs, often in a formulaic manner. These can help identify sectors to focus on in the second stage.

Stage Two: Rebalancing Spending Priorities beyond Budget 2018

19. For the second stage, we recommend selecting a few major sectors or Votes from which to investigate policy settings and savings. This is because, having done the Stage One policy alignment and low value process, the remaining material savings and more significant opportunities to realign spending with government priorities will be most likely found in the large sectors with complex funding formulae and programmes. Moreover, it will simply not be practical for Finance Ministers to oversee in depth policy and baseline reviews across the broad expanse of government activity. Zeroing in on the areas of greatest opportunity for gains is more practical and manageable.

20. In selecting the second stage sectors/agencies to concentrate on for Budgets 2019 and 2020, we will filter the findings from our Vote teams and Ministers' responses to Stage One. In addition, we can also use agencies' cost pressures bids (due this December) to identify where systemic policy is acting as a likely driver of those pressures. This analysis should help identify the major areas where a real effort over the next six to eighteen months should be directed.
21. For Stage Two, you might like to think about establishing some sectoral Ministerial groupings where cross agencies are working towards similar aims and or where policies in one part of government impose costs on another (e.g. the Justice sector). The structure, mandate and membership of these should be contemplated around late February when agreeing which sectors to focus on.
22. One objective of Stage Two would be to free up some fiscal headroom so that Budgets 2019 onwards can be better aligned with a living standards approach. There may also be an opportunity to consider changes to aspects of the Budget process for some sectors, including possibly thinking about cost pressures and baseline efficiency outside the annual cycle of discretionary spending.
23. We recommend that work on Stage Two should begin as soon as Budget 18 is settled (likely in April). We will provide you with more advice on this as we identify the sectors candidates and develop the approach in early 2018.

Draft letter

Dear Minister

In mid-December I will be releasing the Budget Policy Statement alongside the Treasury's Half Year Economic and Fiscal Update, which will communicate our 100 Day Plan. Beyond the 100 Day Plan, there are further commitments and cost pressures to manage through Budget 2018.

As I have noted to Cabinet, my discussions with the Treasury have confirmed that after taking into consideration commitments in the Labour Fiscal Plan, and our coalition and confidence and supply agreements, there is minimal room left for any extra spending in order for us to meet our Budget Responsibility Rules.

Now is therefore the time to realign departmental and other agencies' priorities with our Government's priorities. In order to provide flexibility for any extra spending on top of what is included in the Fiscal Plan, including departmental cost pressures and future fiscal risks, I will be looking for Ministers to identify spending reprioritisation options through Budget 2018.

I expect Ministers to start engaging with agencies to identify reprioritisation options over the next couple of weeks. In the first instance the focus should be on ensuring current spending in agencies' baselines align with the Government's priorities, and after that looking at current spending that is not generating value-for-money.

Whilst the focus is currently on Budget 2018, I will also be looking at how the approach to future budgets can be improved to ensure spending better reflects our Government's priorities of improving living standards for New Zealanders. This has the potential to significantly enhance how Budgets support an improvement in New Zealanders' living standards and funds released through reprioritisation will further realise that potential by being available to spend on worthwhile initiatives. Savings identified early in the process for Budget 2018 will be taken into account in those future budget rounds.

I have delegated consideration of the results of your baseline reviews to Associate Minister of Finance Hon Dr David Clark. I ask that you write to him by 26 January 2018 with the outcome of your reviews. I also expect the Treasury will be in touch with your chief executives with guidance as to how these baseline reviews should be conducted.

Yours sincerely

Hon Grant Robertson
Minister of Finance