

The Treasury

Budget 2018 Information Release

Release Document August 2018

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[2]	to avoid prejudice the entrusting of information to the Government of New Zealand on a basis of confidence by the Government of any other country or any agency of such a Government	6(b)(i)
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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Treasury Report: Budget 2018 - Overview of Initial Cost Pressure Initiatives Received

Date:	19 December 2017	Report No:	T2017/2870
		File Number:	BM-2-1-2018

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	<p>Note the high level analysis on the cost pressure initiatives received.</p> <p>Note the Treasury will provide further advice and analysis in the new year.</p>	20 December 2017
Associate Minister of Finance (Hon Dr David Clark)	None	None
Associate Minister of Finance (Hon David Parker)	None	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Nathan Spence	Analyst, Budget Coordination	[39] (wk)	N/A (mob) ✓
Kamlesh Patel	Team Leader, Budget Coordination	[39] (wk)	N/A (mob)

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

Return the signed report to Treasury.

Note any feedback on the quality of the report

Treasury Report: Budget 2018 - Overview of Initial Cost Pressure Initiatives Received

Executive Summary

The purpose of this report is to provide an overview of operating and capital cost pressure initiatives received by the Treasury on Friday 8 December.

A total of 143 initiatives have been submitted to the Cost Pressure track for Budget 2018 with an average operating cost of \$3.5 billion per annum (a total of \$14.1 billion over the forecast period) and a total capital cost of \$5.8 billion.

The attached Annex provides:

- a) a breakdown of operating and capital cost pressures against the Budget 2018 allowances;
- b) a breakdown of operating and capital cost pressures by sectors; and
- c) a breakdown of operating and capital cost pressures by type (paragraph 18 – 19 outlines the classifications).

For a number of initiatives there are likely to be options around scaling, phasing and deferring which will be explored through the detailed assessment phase. Vote Team assessment of cost pressure initiatives is due January 26, following which we will provide further advice on cost pressure initiatives we recommend are supported through the decision-making process.

Recommended Action

We recommend that you:

1. **note** a total of 143 initiatives have been submitted to the Cost Pressure track for Budget 2018 with an average operating cost of \$3.5 billion per annum (a total of \$14.1 billion over the forecast period) and a total capital cost of \$5.8 billion;
2. **note** that the majority of the operating cost pressures submitted are in the following sectors:
 - a) Health ^[33]
 - b) Education ^[33]
 - c) Foreign Affairs ^[33]
 - d) Justice Sector ^[33]
3. **note** that the majority of the capital cost pressures submitted are in the following sectors:
 - a) Defence ^[33]
 - b) Health ^[33]
 - c) Housing ^[33]
 - d) Education ^[33]
4. **note** that the Treasury has classified the cost pressures into four types: 'Price', 'Volume', 'Personnel' and 'Not a Cost Pressure', and that Volume and Price are the biggest types of cost pressures for operating and capital respectively;
5. **note** that the data used for this initial update is based solely on what agencies have submitted and that for a number of initiatives there are likely to be options around scaling, phasing and deferring which will be explored through the detailed assessment phase;
6. **note** that Vote Team assessment of cost pressure initiatives is due January 26, following which we will provide further advice on cost pressure initiatives we recommend are supported through the decision-making process;
7. **note** that Treasury proposes Vote Teams will prioritise and complete a full assessment of initiatives classified as a cost pressure and deprioritise initiatives classified as 'Not a Cost Pressure';
8. **note** that it is likely that more initiatives will be added to the 'Not a Cost Pressure' category once the Treasury has completed a full assessment.

Kamlesh Patel
Team Leader, Budget Coordination

Hon Grant Robertson
Minister of Finance

Treasury Report: Budget 2018 - Overview of Initial Cost Pressure Initiatives Received

Purpose of Report

1. The purpose of this report is to provide an overview on operating and capital cost pressure initiatives received by the Treasury on Friday 8 December. The Treasury has classified the cost pressures received into the following types:
 - Volume cost pressure
 - Personnel cost pressure
 - Price cost pressure
 - Not a cost pressure
2. This report identifies key initiatives and sectors we think are important for you to have early visibility of, and also outlines next steps the Treasury will undertake in the analysis of the cost pressure information.

Overview of Initiatives Received

3. Cost pressure initiatives were submitted by agencies on Friday 8 December. A total of 143 initiatives have been submitted in the cost pressure track with an average operating cost of \$3.5 billion per annum (a total of \$14.1 billion over the forecast period) and a total capital cost of \$5.8 billion.
4. The attached Annex provides:
 - a) a breakdowns of operating and capital cost pressures against the Budget 2018 allowances;
 - b) a breakdown of operating and capital cost pressures by sector; and
 - c) a breakdown of operating and capital cost pressures by type (paragraph 18 – 19 outlines the classifications).
5. The initial analysis of initiatives shows that the allowances are heavily oversubscribed, particularly given that manifesto initiatives are yet to be submitted.
6. The Budget 2018 operating allowance is oversubscribed by \$900 million per annum by cost pressure submissions alone, while the capital allowance remaining after pre-commitments is oversubscribed by \$3.1 billion for Budget 2018.
7. It is important to note that the data used for this initial update is based solely on what agencies have submitted, and it is likely that these numbers will be scaled down following a Treasury assessment of initiatives. The Annex provides a very conservative estimate of what Vote Teams consider are not cost pressures, and advice will be further developed early next year as Vote Teams assess the initiatives.
8. For Budget 2017, cost pressures of approximately \$1.35 billion per annum operating were submitted. In contrast, cost pressures of approximately \$3.5 billion per annum operating have been submitted for Budget 2018.

9. Further advice and analysis on cost pressures submitted through agencies' Four Year Plans received on Friday 15 December will be provided in early 2018.

Breakdown of Cost Pressure Initiatives by Type

10. The Treasury has classified the cost pressures received into the following types:
- a) **Volume:** Initiatives which are categorised as a volume pressure primarily reflect higher demand for the service under current policy settings. This can be driven by higher population growth, changes in population characteristics or legislative requirements which result in higher demand for a new or existing service.
 - b) **Personnel:** Initiatives which are categorised as a personnel pressure primarily reflect collective bargaining agreements and wage progression pressures.
 - c) **Price:** Initiatives where the cost of delivering or continuing to deliver a service is now higher are categorised as price driven pressures. This could be driven by a number of factors including:
 - i external market factors (e.g. inflation, interest rates, house prices)
 - ii the initiative was under-costed at the time funding was approved as a result of information asymmetry
 - d) **Not a cost pressure:** An initiative has been categorised as not a cost pressure if it is seeking funding
 - i for a service not currently being delivered by the agency (unless this is driven by legislation)
 - ii to extend a current service or add on extra components
 - iii to extend a time limited service (e.g. pilot or trial) and further policy decisions are required
 - iv there is a high level of discretion for Ministers around the funding decision with minimal impact on service delivery if no decision is taken for Budget 2018
11. It is important to note that the 'not a cost pressure' category is only made up of initiatives where the entire initiative is not a cost pressure. Where one component of an initiative is driven by volume, personnel or price pressures, we have added the initiative to that category. Consequently, more initiatives are likely to be added to the 'not a cost pressure' category once the Treasury has completed a full assessment in January 2018.

Further Assessment of Cost Pressure Initiatives

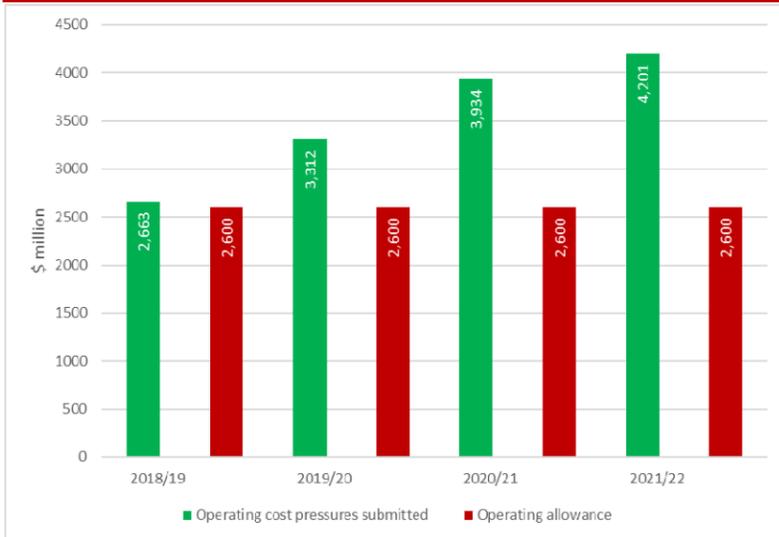
12. The Treasury will be engaging further with agencies and assessing cost pressure initiatives over January. The following approach will be taken to the assessment of these initiatives:
- a) Vote Teams will prioritise and complete a full assessment of initiatives classified as either price, personnel or volume pressures. For a number of initiatives there are likely to be options around scaling, phasing and deferring which will be explored through the detailed assessment phase.

- b) Initiatives that have been classified as 'not a cost pressure' will be deprioritised. Vote Teams will provide a summary assessment of the rationale for why it is not a cost pressure. We can provide further advice on these initiatives to support ministerial discussions if required.
13. Final assessments from Vote Teams are due on Friday 26 January, following which we will provide further advice on cost pressure initiatives we recommend are supported through the decision-making process. Subsequent advice will also include analysis on manifesto initiatives submitted on January 26 and reprioritisation options.
 14. In addition, we will provide a report detailing departments' medium-term cost pressures, as identified through the Four-Year Plan reporting process. This will also include analysis of the extent to which ten large departments (measured by spending level) intend to manage their pressures through strategic responses.¹ This information will provide context when the time comes to set the operating allowances for Budget 2019.

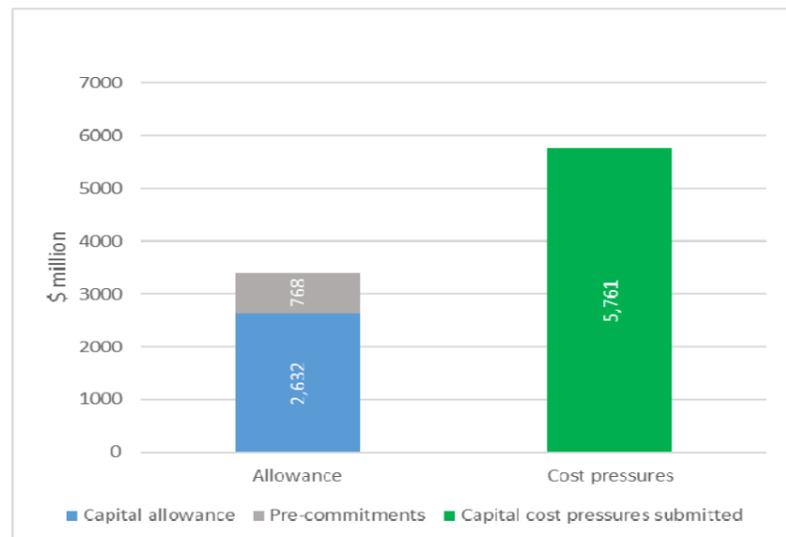
¹ The ten agencies: MOH, MOE, NZDF, DOC, MBIE, MOJ, Police, Corrections, DIA and IR.
T2017/2870 : Budget 2018 - Overview of Initial Cost Pressure Initiatives Received

ANNEX – SUMMARY OF INITIAL COST PRESSURE INITIATIVES

Operating allowances and cost pressures submitted



Capital allowances and cost pressures submitted



Operating and capital cost pressures by sectors

[33]

Operating

Health [33] - Majority of cost is due to two large initiatives for additional DHB support [33]

Education [33] - Large pressures relating to [38] as well as responding to volume and price pressures on core schooling activity. There are also some smaller initiatives relating to pressure on specialist school services and discrete programmes.

Foreign Affairs [33] - Largely comprised of a large Official Development Assistance international aid initiative. Other pressures relate to MFAT baseline operations, and the upcoming APEC21 event.

Justice Sector [33] - Initiatives predominantly relate to core criminal justice pipeline activities, including capacity pressure on the prison network and the courts, and [38]

[33]

Capital

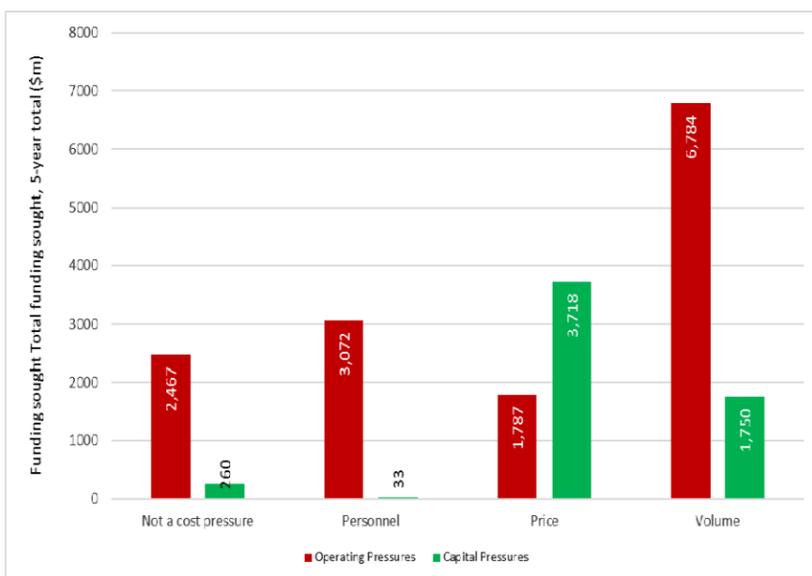
Defence [33] Cost pressures are driven by the policy outlined in the Defence White Paper. They include a large capital initiative relating to the acquisition of P-8A aircraft.

Health [33] - Comprised of funding for a range of DHB capital investment.

Housing [33] - Initiatives relate to the construction of state and transitional housing, including funding for investment in the Tamaki Redevelopment Company.

Education [33] - Funding for the School Growth Package, including new school builds and school expansions in response to population growth and demographic changes across the schooling network.

Operating and capital funding sought as cost pressure initiatives, by cost pressure type



The **'not a cost pressure'** category is primarily comprised of the [33] a initiative for [33] and a large Official Development Assistance initiative.

The **personnel pressures** category is largely driven by [38] and Defence White Paper 2016 operating costs.

The **price pressures** operating category is primarily driven by initiatives for transitional housing supply, APEC 21 and acquisition of P-8A aircraft. Capital price cost pressures reflects the P-8A aircraft acquisition initiative and a DHB capital Investment initiative.

The **volume pressures** operating category primarily reflects initiatives for [33] DHBs, Disability Support, additional prison capacity and Education forecast changes. Capital volume pressures reflect initiatives for [33] Tamaki Redevelopment and a School Growth package.