

The Treasury

Budget 2018 Information Release

Release Document August 2018

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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: Bilateral with Minister Peters [#2]

Date:	9 March 2018	Report No:	T2018/504
		File Number:	DH-10-0-9

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	<p>Discuss with Minister Peters opportunities for scaling across his portfolios</p> <p>Agree an in-principle package, subject to confirmation by Budget Ministers.</p>	Monday 12 March

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Laura Browne	Analyst	[39] (wk)	N/A (mob)	✓
Rachel Pettigrew	Senior Analyst	[39] (wk)	N/A	
Erin King	Acting Team Leader	[39] (wk)	N/A (mob)	

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

Return the signed report to Treasury.
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Note any feedback on the quality of the report

Enclosure: No

Executive Summary

You are meeting Minister Peters on Monday 12 March to discuss the Budget initiatives for Vote Foreign Affairs and Trade, Vote Official Development Assistance, and Vote Racing. This report builds on our previous advice (T2018/20) and provides some concrete options for you to discuss with Minister Peters for each of the initiatives that you are considering funding.

Overall, \$5.5 billion operating per annum and a total of \$9.7 billion capital has been sought for Budget 2018. This compares to allowances of \$2.6 billion per annum for operating and a total of \$3.4 billion for capital.

In light of this, we recommend that in your discussion with Minister Peters you

- **emphasise that final decisions will be made by Budget Ministers, and**
- **agree an in-principle package for Minister Peters' portfolios that will be subject to confirmation by Budget Ministers.**

Scaling options and recommendations

APEC21:

In the last bilateral, Ministers agreed to reduce the contingency component of the initiative. Reducing the contingency component of this initiative will increase the risk of further funding being sought in later years.

We recommend you agree in-principle to reduce the contingency for the APEC21 initiative by no more than \$10 million.

MFAT Departmental funding:

Following your bilateral with Minister Peters, you indicated that you would address immediate and implementation ready cost pressures; wanted to lift capability in a way that *'makes a difference for New Zealand's representation internationally'*; and do not want to fund capital initiatives which are underdeveloped, non-urgent or still require significant strategic choices to be taken.

We recommend you agree in-principle to MFAT Departmental funding of **\$29.5 million p.a.** operating and **\$40.3 million** capital (Option 1). In our view, this option will achieve your objectives in the least costly way by:

1. Addressing **Capital pressures** through a capital injection of \$35.5 million to fund health and safety and protective security requirements
2. Addressing **Operating pressures** by funding 60% of the forecast deficit
3. Providing an **Additional Capability Package** by
 - Funding only the capital injection for a new post in Stockholm;
 - [38]
 - Hiring an additional 12 FTE.

Official Development Assistance:

In the last bilateral, you indicated that you want to consider a cash injection this budget [33], [38]

We recommend you agree in-principle to increase ODA by an average of \$116.7 million per annum to bring ODA spending up to an average of 0.26% of GNI across the triennium (Option 1).

Racing Initiatives:

Bloodstock initiative

Following officials' latest report containing an updated proposal (T2018/463 refers), you agreed Inland Revenue should submit a late Budget bid for the bloodstock initiative. [33]

[33]

Recommended Action

We recommend that you:

- a **note** that the pressure this budget is under and the cumulative impact that Minister Peters' budget initiatives will have on your ability to fund other cost pressures and priorities
- b **note** that we recommend you agree an in-principle package with Minister Peters that will be subject to confirmation by Budget Ministers

APEC21

- c **agree in-principle** to reduce the contingency for the APEC21 initiative by no more than \$10 million

Agree/disagree.

MFAT Departmental Funding

- d **agree** to raise the following points in your discussion with Minister Peters:

- [26]
- ask where he sees the most critical FTE shortages;

Agree/disagree.

- e **agree in-principle** to MFAT Departmental funding of \$29.5 million p.a. operating and \$40.3 million capital (Option 1)

Agree/disagree.

Official Development Assistance

- f **agree in-principle** to increase ODA by \$116.7 million p.a. to bring ODA spending up to an average of 0.26% of GNI across the triennium (Option 1),

Agree/disagree.

[33]

Agree/disagree.

Bloodstock initiative

- h **agree** to fund as part of the 'other' workstream package, [33]

Agree/disagree.

Erin King
Acting Team Leader

Hon Grant Robertson
Minister of Finance

Treasury Report: Budget 2018: Bilateral with Minister Peters [#2]

Purpose of Report

1. You are meeting Minister Peters on Monday 12 March to discuss the Budget initiatives for Vote Foreign Affairs and Trade, Vote Official Development Assistance, and Vote Racing. This will build on your previous discussion with Minister Peters last month where he identified his top priorities for Budget 2018 across his portfolios.
2. This report provides you with some further options that we have developed in light of your previous discussion. The options we present are a subset of options available that we believe balance your fiscal objectives against Ministerial priorities. This builds on our previous report (T2018/20) which outlined our initial advice and context for these initiatives.

Context

Budget 2018 context

3. Overall, \$5.5 billion operating per annum and a total of \$9.7 billion capital has been sought for Budget 2018. This compares to allowances of \$2.6 billion per annum for operating and a total of \$3.4 billion for capital. Ministers have expressed a commitment to these allowances in their Budget Responsibility Rules for Budget 2018.
4. Of Minister Peters' budget initiatives, only the APEC21 initiative has been included in the draft packages that have been presented to you at this stage as this initiative is rated red under the RAG rating for prioritising initiatives (T2018/515 refers).
5. Given the pressure this budget is under and the cumulative impact that Minister Peters' budget initiatives will have on your ability to fund other cost pressures and priorities, we suggest you emphasise that final decisions will be made by Budget Ministers. We also recommend that you **agree an in-principle package for Minister Peters' portfolios that will be subject to confirmation by Budget Ministers.**

Last Bilateral Discussion with Minister Peters

6. You met with Minister Peters on Monday 12 February for a first discussion of the Budget initiatives across his portfolios. Following the bilateral, you advised us of the following outcomes of your discussion:
 - a. **APEC21:** Ministers agreed to reduce the contingency component of the initiative.
 - b. **MFAT Departmental funding:** You requested further analysis of components that will raise the capability of New Zealand's offshore network as well as scaling options. ^[26]
 - c. **Asia NZ:** You agreed not to fund this initiative.
 - d. **Official Development Assistance:** You indicated that you want to consider a cash injection this budget ^{[33], [38]}
 - e. ^[33]

You also discussed a late initiative being submitted to address a tax issue for the bloodstock industry.

A. APEC 2021 Programme

7. In your last bilateral, you discussed with Minister Peters the option to lower the fiscal impact of APEC21 in Budget 2018 by \$10 million through a reduction in the general contingency. This would reduce the funding for APEC21 to **\$189.7 million**.
8. **We recommend you agree in-principle to reduce the contingency for the APEC21 initiative by no more than \$10 million.** Reducing the level of funding set aside in the general contingency will increase the risk that costs will overrun the funding allocated and lead to further funding being sought in future budgets. The Quantitative Risk Analysis (QRA) determined that, based on the risk profile, there is:
 - [33]
 -
9. The Treasury has been discussing ways to manage contingency funding with the Ministry and we are in agreement that:
 - a. [33], [38]
 - b. Appropriating the remaining contingency funding to be managed by the Ministry and the APEC21 project team in accordance with usual practice. Current financial delegations would apply to this funding.

[33], [38]

10.

11.

B. MFAT Departmental Funding

12. The Minister of Foreign Affairs submitted five initiatives seeking a total of ^[33] **p.a. operating and \$279.8 million capital.**
13. Following your meeting with Minister Peters, we have considered options that will meet the following objectives:
- a. address immediate and implementation ready cost pressures;
 - b. lift capability in a way that *'makes a difference for New Zealand's representation internationally'*; and
 - c. do not fund capital initiatives which are underdeveloped, non-urgent or still require significant strategic choices to be taken.
14. **We recommend you agree in-principle to MFAT Departmental funding of \$29.5 million p.a. operating and \$40.3 million capital.** In our view, this option is the most cost effective way to achieve your objectives by:
- a. Addressing **Capital pressures** through a capital injection of \$35.5 million to fund health and safety and protective security requirements
 - b. Addressing **Operating pressures** by funding 60% of the forecast deficit
 - c. Providing an **Additional Capability Package** by
 - i. Funding only the capital injection for a new post in Stockholm;
 - ii. [38]
 - iii. Hiring an additional 12 FTE.
15. The rest of this section provides you with greater detail on our recommended option above and also sets out some alternative options for you to consider.

Capital pressures

16. The total funding being sought for this component is ^[33] operating and
^[33] capital. The capital includes:
- *Health & safety and protective security requirements* \$35.5 million
 - *Unfunded property costs: Pacific, Washington, Riyadh* ^[33]
 - *Modernising information management and communications*
 - ^[33]

[33], [38]

17. To address capital pressures, **we recommend you agree in-principle to fund a capital injection of \$35.5 million (option 1 above)**. This is the most urgent capital pressure and is implementation ready.

[33]

Operating pressures

18. The total funding being sought for this component is **\$22.1 million p.a.**

[33], [38]

19. To address operating pressures, **we recommend you fund 60% of MFAT's forecast deficit (option 1 above)**. While this option would still require MFAT to find efficiency savings, we consider this to be good practice. MFAT typically underspends in some areas every year suggesting there is still scope to make savings.

Additional capability package

20. The total funding being sought for additional capability is **\$20.6 million p.a.** operating and **\$4.8 million** capital. The options in our previous report did not include any funding for these components, we understand in light of your discussion with Minister Peters that you would like to include a package that lifts capability in a way that *'makes a difference for New Zealand's representation internationally'*.

21. There are three potential components that, in our view, would address Minister Peters' concerns. We present options for each of these three components below.

Open a new post in Stockholm, Sweden		
[26]		
✓	Option 1: Fund operating costs through post closure or other reprioritization. Closing a post is unlikely to generate capital savings so this will need to be funded.	\$4.8m capital
	Option 2: Fully fund both operating and capital components.	\$2.8m p.a. operating; \$4.8m capital
[38]		

Additional FTE

Minister Peters is seeking an additional 60 FTE. However, given the increase in staffing secured through Budget 2017, we recommend a more modest increase, and that an increase be phased accordingly. **We recommend asking Minister Peters where he sees the most critical FTE shortages.**

✓	Option 1: Funding would provide for an <u>additional 12 FTE (3 per annum).</u>	\$2.6m p.a. operating
	Option 2: Funding would provide for an <u>additional 24 FTE (6 per annum).</u>	\$5.1m p.a. operating
	Option 3: Funding would provide for an <u>additional 36 FTE (9 per annum).</u>	\$7.7m p.a. operating

22. **We recommend the following components form the basis of a package** to raise capability within MFAT and in New Zealand's offshore network:

- a. Fund only the capital injection for a new post in Stockholm;
- b. [38]
- c. Hire an additional 12 FTE.

Summary of options

23. Putting these options together gives three overarching options for MFAT Departmental funding. You can also combine the components in different ways depending on your preferences.

[33], [38]

Operating (p.a.) Capital

C. Official Development Assistance

24. Following the budget bilateral with the Minister of Foreign Affairs, we understand you are interested in exploring ways to increase funding for Official Development Assistance (ODA) that balance our international commitments, development needs, and the capacity to deliver outcomes in an effective and efficient manner. [33], [38]

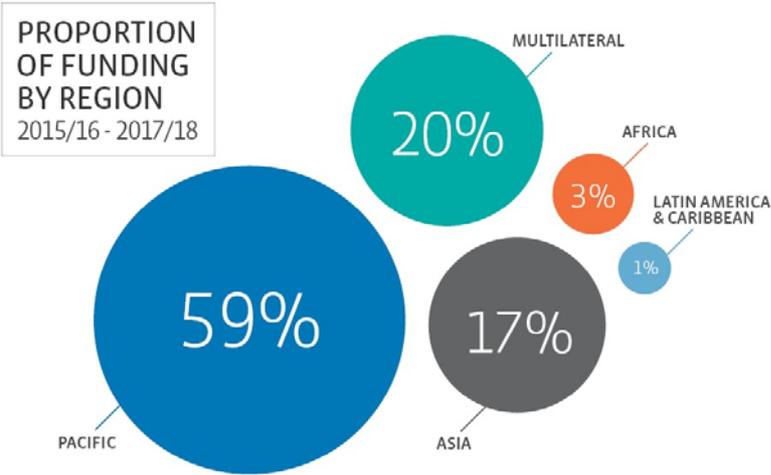
Context

25. The last significant increase in ODA was during Minister Peters’ previous tenure as Minister of Foreign Affairs in Budget 2007 and aimed to “take New Zealand’s reported ODA to 0.35% of GNI by 2010/11.” This committed an average of \$148.0 million p.a. A significant portion of this funding was reversed in subsequent budgets. Funding was subsequently approved in Budget 2015 to lift ODA to around 0.27% of GNI across the triennium. Funding for ODA is managed on a triennium basis via a three year multi-year appropriation (MYA)².

26. Across the current triennium (2015/16 – 2017/18), New Zealand’s ODA has been **0.26%** of GNI on average³. Without new funding, this will fall to **0.23%** of GNI for the next triennium, and decline further to **0.20%** for the following triennium.



27. In light of the recent Cabinet discussion (NSC-18-MIN-0001) and your comments following the previous bilateral, we understand that you would like the Pacific to be a focus of any increases to ODA. The diagram below shows the approximate breakdown of ODA in the current triennium. The ODA budget 2018 initiative is premised on a continuing focus on the Pacific.



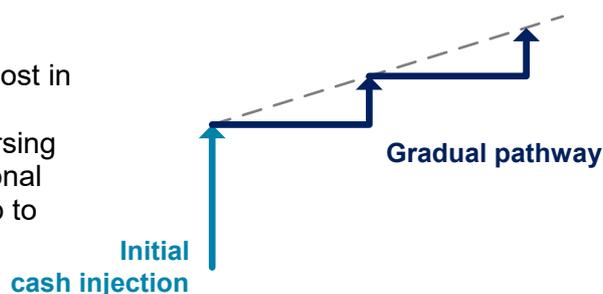
² MYAs provide the Ministry with the flexibility to move funding between years. Funding typically appears higher in the final year of the MYA, which can arbitrarily increase the ratio for that year.

³ The ratio is forecast to be 0.27% in 2017/18 but only because funding has been moved into the last year of the triennium and is not representative of the average for the triennium. Therefore the average ratio of ODA to GNI across the triennium (or forecast period) is a more useful measure to discuss.

Approach to funding

28. To ensure New Zealand's ODA continues to lift, [33], [38] funding will be required at regular intervals. In order to support the way ODA funding is planned and managed, **we recommend funding increases are considered every three years to coincide with the start of each triennium.**
29. In line with this, **we recommend that the funding agreed this Budget only increases the level of ODA across the next triennium** (i.e. the funding in 2021/22 and outyears is the same as for 2020/21). This will reduce the outyear cost of the ODA initiative (relative to increasing ODA across the forecast period).
30. There are two main aspects to consider when deciding the increase given to ODA funding in this budget.

- **Initial cash injection.** An initial boost in funding in 2018/19 to signal the Government's commitment to reversing the declining trend. Without additional funding, the ratio is forecast to drop to 0.24% of GNI.
- **Gradual pathway.** Subsequent incremental increases to demonstrate that the Government is on a pathway [33], [38]



Options for Budget 2018

31. We have presented three options for you to consider (note these have been prepared using HYEPU forecasts of GNI, the MFAT options has been updated). A full breakdown of these options is provided in Appendix B.

		Average cost p.a.	
Option 1	Average of 0.26% of GNI across the forecast period	\$116.7m p.a.	18% increase over Vote ODA baselines
Option 2	Average of 0.27% of GNI	\$147.2m p.a.	21% increase
Option 3	Average of 0.28% of GNI	\$177.8m p.a.	27% increase
MFAT Option	Average of 0.32% of GNI	\$305.6m p.a.	47% increase

The Medium term

32. This funding strategy only commits funding for the next triennium. Future increases to the ODA budget would need to be considered and prioritised against subsequent budgets (the budget corresponding to the beginning of each triennium).

33. [33], [38]

34. [33], [38]

D. Racing Initiatives

[33]

Bloodstock initiative

41. On 1 March 2018 officials reported to you on an updated proposal for the bloodstock initiative (T2018/463 refers). Inland Revenue will submit this initiative as a late bid for Budget 2018.
42. [33]

Appendix A – Departmental Funding

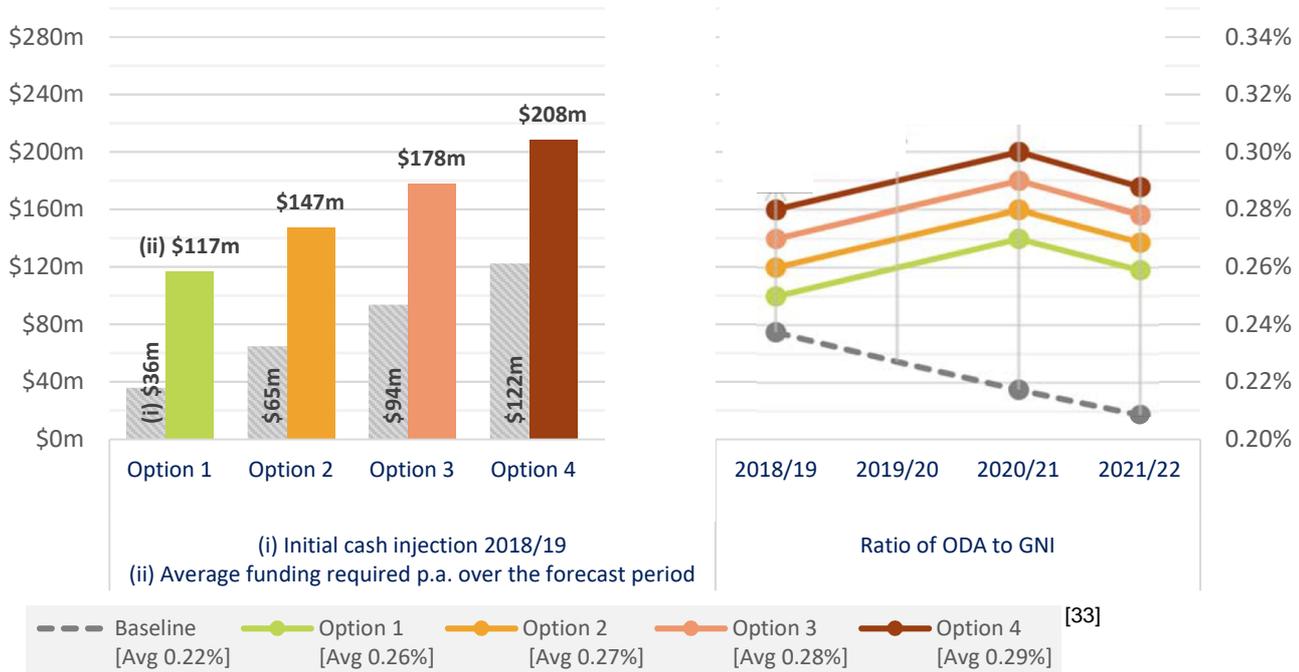
[33], [38]

Mapping components with initiatives as submitted

Initiatives submitted by the Ministry	Components
<p>Capital Cost Pressures <i>To meet cost pressures including Health and Safety, Protected Security Requirements, modernising information management and communication systems and aged infrastructure offshore.</i></p> <p>[33]</p>	<p>Capital pressures</p>
<p>Cost Pressures <i>To address the forecast deficit arising from inflationary cost pressures.</i></p>	<p>Operating pressures</p>
<p>Capability – additional resourcing <i>To sustain a career Foreign Service onshore and offshore.</i></p> <p>New Embassy in Stockholm</p>	<p>Additional capability</p>

Appendix B – Official Development Assistance

Comparing funding options for ODA [33]



	New funding required (\$m)					% increase over current Vote ODA baseline	Ratio of ODA to GNI				
	18/19	19/20	20/21	21/22	Avg.		18/19	19/20	20/21	21/22	Avg.
Option 1	\$36.0	\$99.2	\$165.8	\$165.8	\$116.7	18%	0.25%	0.26%	0.27%	0.26%	0.26%
		+\$63.2	+\$66.6								
Option 2	\$64.8	\$129.4	\$197.4	\$197.4	\$147.2	23%	0.26%	0.27%	0.28%	0.27%	0.27%
		+\$64.7	+\$68.0								
Option 3	\$93.6	\$159.7	\$229.0	\$229.0	\$177.8	27%	0.27%	0.28%	0.29%	0.28%	0.28%
		+\$66.1	+\$69.4								
Option 4	\$122.4	\$189.9	\$260.6	\$260.6	\$208.4	32%	0.28%	0.29%	0.30%	0.29%	0.29%
		+\$67.5	+\$70.7								

[33]

Note this calculation is based on GNI forecast HYEFU, and that reportable ODA from other votes remains constant at \$38.2m p.a.