

# The Treasury

## Budget 2018 Information Release

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# **Budget Ministers 2**

## **Budget 2018 – Draft Package**

Budget Material for the Deputy Prime Minister

**19 March 2018**

# Purpose

The key objectives for this meeting are to:

- Provide an overview of the draft Budget package and discuss key trade-offs required to remain within Budget 2018 operating and capital allowances.
- Discuss key risks beyond Budget 2018.

**The purpose of Budget Ministers 2 is to seek broad agreement to the draft Budget package and identify areas requiring further development. The draft package agreed at Budget Ministers 2 will be provided to workstream ministers for feedback. A near final Budget package will then be prepared for agreement at Budget Ministers 3 on Monday 26 March.**

**To support the discussion attached to this slidepack is the draft Budget package broken down by workstreams.**

# Contents

- Executive Summary
- Budget 2018 Draft Package
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- Risks Beyond Budget 2018
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# Executive Summary

- The draft package aims to balance Ministerial priorities that were discussed at workstream meetings and bilateral discussions with a prioritisation of initiatives based on risk and scope.
- Overall, the draft operating package is **\$2.673 billion per annum** and the draft capital package is **\$3.640 billion**.
- In order to get both the operating and capital packages to fit broadly within allowances, key trade-offs and scaling was required across all workstreams.
- Staying within the Budget 2018 allowances set in the 2018 Budget Policy Statement will ensure we remain on track to meet our Budget Responsibility Rules.
- The stronger year to date tax outturns are likely to provide some additional fiscal headroom compared to the Half Year Economic and Fiscal Update. However with emerging risks it is important any additional headroom is carefully managed to help manage future challenges we may face (e.g. future economic shocks) and maintain the integrity of the Budget Responsibility Rules.
- Following this meeting I will be holding workstream meetings to discuss the draft package with portfolio Ministers.
- **The near final Budget package will need to be approved at Budget Ministers 3, for Cabinet consideration on Monday 9 April.**

# Development of the Draft Package

- In developing the draft packages, the Treasury has advised on the potential weighting of initiatives based on:
  - the risks and implications associated of not funding cost pressures; and
  - the scope, implementation readiness and accuracy of costing across manifesto initiatives
- In addition Minister Clark and Minister Parker have chaired meetings across the workstreams to identify Ministerial priorities for initiatives submitted.
- Bilateral meetings have been held for large and complex portfolios to identify trade-offs against Ministerial priorities in coming up with the draft package.

Overall, the draft package presented to Budget Ministers 2 aims to balance the Treasury's assessment criteria alongside Ministerial priorities and bilateral discussions to form a package almost within allowances.

- The draft package for operating is **\$2.673 billion average per annum** and exceeds the operating allowance by \$73 million.
- The draft package for capital is **\$3.640 billion in total** and exceeds the capital allowance by \$240 million.

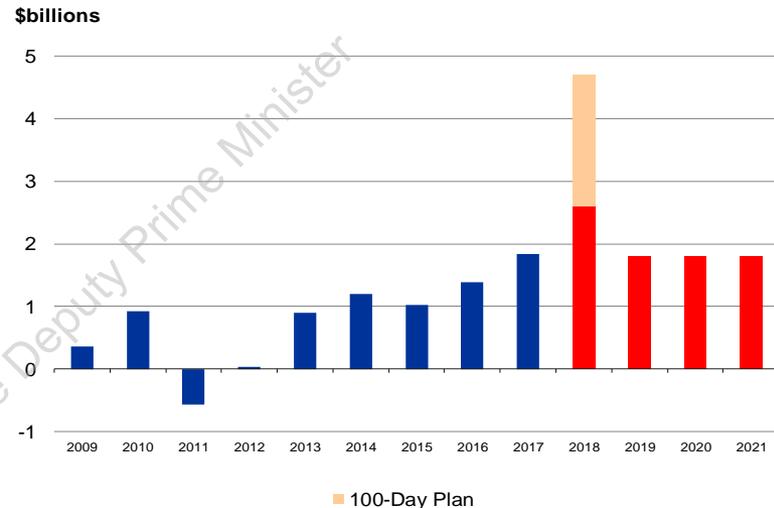
# Overview of Budget 2018 Draft Package

The Government has already made significant progress on its priorities through the 100-Day Plan. Budget 2018 makes further progress on these priorities, with a focus on meeting cost pressures, rebuilding core services (particularly in the health and education sector), housing and supporting the business community and wealth creation.

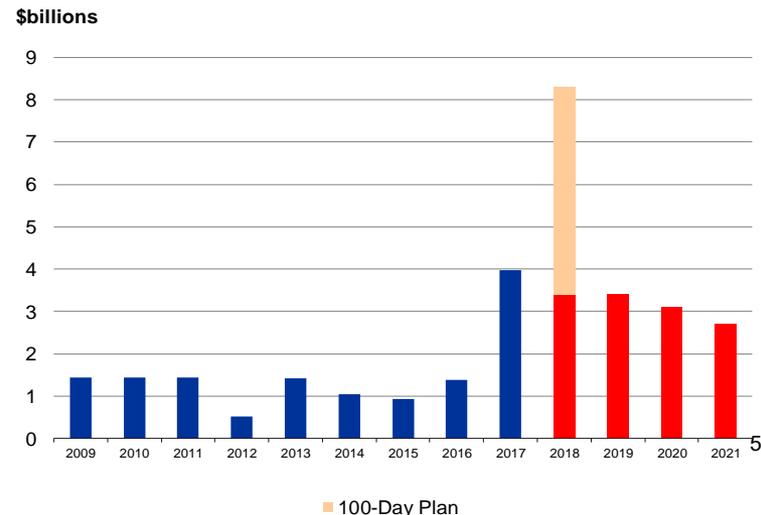
\$million	Draft Operating Package (average per annum)	Draft Capital Package (Total)
Social Wellbeing	1,897.923	208.643
Economic Development	665.436	661.412
Infrastructure	111.586	1,597.762
Natural Resources	73.005	188.950
Other	123.064	83.637
Pre-commitments	67.360	902.139
Between Budget contingency	50.000	-
Reprioritisation	(120.490)	(3.000)
Revenue initiatives	(194.900)	-
<b>Total</b>	<b>2,672.984</b>	<b>3,639.543</b>

\*Please note that some of these totals will not add due to rounding.

Operating allowances spending (per Budget)



Capital allowances spending (per Budget)



# Budget 2018 Draft Package – Social Wellbeing

Overall the Social Wellbeing draft package stands at an average of **\$1.898 billion** per annum in operating and **\$209 million** in capital. The majority of the Social Wellbeing package is driven by cost pressures.

\$million	Operating (average per annum)	Capital (Total)
Health	770.801	100.000
Education	[33]	[33]
Justice sector *	247.177	18.100
Other sectors	282.017	90.053
<b>Total</b>	[33]	[33]

\*This includes the following portfolios: *Justice, Courts, Police and Corrections*

## Key implications:

The Social Wellbeing draft package is largely compromised of high to medium risk cost pressures in areas such as Health, Education and the Justice sector. Initiatives have been scaled or deferred (where feasible) to ensure the package only reflects funding for genuine volume, price and personnel driven pressures which are required for 2018/19 and are relatively non-discretionary in nature (and not any service improvements).

Cutting the package further to include additional Ministerial priorities will require trade-offs in certain areas (including with existing manifesto commitments in the package) and/or applying arbitrary cuts to initiatives to reduce fiscal costs.

## The draft package includes additional funding of:

- \$489 million operating per annum to DHBs to support pressures in delivering core health services;
- \$246 million operating per annum to fund price and demographic changes related to schools and early childhood education;
- [38]
- \$86 million per annum operating and \$69 million capital for public and transitional housing supply; and
- \$70 million per annum operating and \$18 million capital for striving towards 1,800 new police.

## The draft package excludes the following items:

- Teacher Aide Funding Rates ([33] per annum operating);
- Expanding Housing First (\$12 million per annum operating); and
- Pay Equity for Social Workers (\$20-\$24 million per annum operating)
- National bowel screening programme (\$17 million per annum operating)

# Budget 2018 Draft Package – Economic Development

Overall the Economic Development draft package stands at an average of **\$665 million** per annum in operating and **\$661 million** capital.

\$million	Operating (average per annum)	Capital (Total)
Provincial Growth Fund*	101.751	188.800
Research, Science and Innovation	274.433	11.925
Housing and Urban Development	12.054	[33]
Foreign Affairs	222.958	40.281
Other	54.200	3.900
<b>Total</b>	<b>665.396</b>	[33]

\*Excludes pre-commitments and repurposed funding – total funding for year 1 = \$1 billion.

## Key implications:

The Economic Development draft package is largely made up of funding for the Foreign Affairs, Research, Science and Innovation and Housing and Urban Development portfolios.

A key assumption in the above funding split relies on the Provincial Growth Fund being treated as an annual \$1 billion Fund over the next three Budgets, rather than counting the full \$3 billion against Budget 2018.

Ministers will have key decisions to make around the phasing of the Provincial Growth Fund over the next three Budgets, and on a strategy to reach the Research and Development goal of funding reaching 2% of GDP in 10 years.

## The draft package includes additional funding of:

- \$102 million per annum operating and a total of \$189 million capital for the Provincial Growth Fund;
- \$256 million per annum operating funding for Research and Development Tax Credit;
- [33] million capital investment in Tamaki Redevelopment Company; and
- \$147 million per annum for Official Development Assistance.

# Budget 2018 Draft Package – Infrastructure

Overall the Infrastructure draft package stands at an average of **\$112 million** per annum in operating and **\$1.6 billion** capital. The majority of the Infrastructure package is driven by cost pressures.

\$million	Operating (average per annum)	Capital (Total)
Health	-	[37]
Education	[33]	[33]
Corrections	87.089	[33]
Other	4.743	-
<b>Total</b>	<b>111.586</b>	<b>1597.762</b>

### *The draft package includes additional funding of:*

- \$750 million total of capital for investment in District Health Boards;
- \$332 million total of capital for the Schools Growth Package;
- [33]
- \$198 million total of capital and \$76 million operating per annum to respond to prison volume growth; and
- [37] million in capital for design costs for Dunedin Hospital.

### *Key implications:*

The Infrastructure draft package is largely comprised of high risk cost pressures so there is minimal discretion.

A key initiative currently not included is \$299 million in total for the Christchurch Regeneration Acceleration Facility. Whether the funding is operating or capital is still to be determined.

The Christchurch Schools Rebuild initiative has been scaled from [33] million total of capital and [33] million operating per annum, to \$62 million capital and average of \$6 million operating per annum. This provides funding for the 2018/19 year only.

# Budget 2018 Draft Package – Natural Resources

Overall the Natural Resources draft package stands at an average of **\$73 million** per annum in operating and **\$189 million** in capital. The majority of the Natural Resources package is driven by manifesto initiatives.

\$million	Operating (average per annum)	Capital (Total)
Conservation	[33]	-
Forestry	[33]	88.800
Climate Change	7.544	100.150
Other	17.395	-
<b>Total</b>	<b>73.005</b>	<b>188.950</b>

## Key implications:

The Natural Resources draft package is largely made up of manifesto initiatives.

You will have key decisions to make on the Conservation package, and how you wish to approach a 'significant increase in DOC's baseline' over the next three Budgets. You will also have key decisions to make on the amount of funding from the One Billion Trees initiative that is to be counted against the Provincial Growth Fund.

You will also have key decisions to make on [33] which have not made it into the current draft package, [33]

## The draft package includes additional funding for:

- A Conservation package of [33] per annum of operating funding to support DOC's capability and predator control;
- [33] operating and a total of \$89 million capital to establish the foundation for One Billion Trees; and
- \$6 million per annum operating and \$100 million capital for the Green Investment Fund.

## The draft package excludes:

- [33]

- [33]

# Budget 2018 Draft Package – “Other”

Overall the “Other” draft package stands at an average of **\$123 million** per annum in operating and a total of **\$84 million** in capital. The majority of the “Other” package is driven by cost pressures.

\$million	Operating (average per annum)	Capital (Total)
Defence	84.705	41.311
Internal Affairs	8.090	10.906
State Services	7.566	31.230
Other Sectors	22.703	0.19
<b>Total</b>	<b>123.064</b>	<b>83.637</b>

## Key implications:

- Consider how much funding to set aside for the Defence White Paper in Budget 2018 ahead of reviewing Defence policy settings and discuss approach to P8-As.
- Consider the counterfactuals of not funding initiatives identified with a “resilience” focus and identify which resilience initiatives (if any) are of key priority to the Government in Budget 2018, e.g. the MSD initiatives “Improving the Resilience of Business Critical Systems” and “Additional Crown Support for Kaikōura Recovery.”
- Discuss the data and digital strategy across Government and decide which initiatives best contribute to this strategy across both the “Other” and “Economic Development” workstreams.

## The draft package includes funding for:

- \$84 million per annum of operating funding to meet the Defence White Paper (2016) operating pressures;
- \$41 million total of capital for the Defence Estate Regeneration Programme;
- Funding to resolve Wellington Accommodation Project cost pressures of \$8 million operating per annum and a total of \$31 million total of capital;

• [33]

- Departmental operating funding for the Ministry for Culture and Heritage \$5.823 million operating per annum.

## The draft package excludes:

- [33] operating per annum and a total of [33] capital for the purchase of P8-As;

• [33]

•

# Reprioritisation and Revenue Options

- Overall a total of **\$120 million** per annum in operating and a total of **\$3 million** in capital has been made available from this year's reprioritisation exercise.
- The largest reprioritised funding was identified in the Education, Agriculture and Health portfolios.
- To ensure that all our spending aligns to our priorities it is important that the reprioritisation of low priority funding continues beyond 2018. I intend to signal a work programme for reprioritisation for the coming year in the Budget 2018 Cabinet Paper.
- In addition an average of **\$195 million** operating per annum of revenue initiatives have been identified to offset against the operating allowances. The revenue initiatives comprise:
  - tax treatment of ring-fenced losses
  - collecting GST on low value goods; and
  - additional revenue from increased compliance activity

# Staying Within Allowances

- The draft package for operating is **\$2.673 billion average per annum** and exceeds the operating allowance by \$73 million.
  - To remain within the \$2.6 billion envelope for operating expenditure, this will require making a one-for-one trade-off if further ministerial priorities are added in to the package.
  - I recommend we discuss the relative weighting of the draft operating package, whether it currently reflects your priorities and what changes you would like to see for the near final version for Budget Ministers 3 on Monday 26 March.
- The draft package for capital is **\$3.640 billion in total** and exceeds the capital allowance by \$240 million.
  - Remaining within the \$3.4 billion capital allowance will require consideration of scaling large capital initiatives to the 'minimum viable' option, including:
    - DHB capital investment
    - Schools Growth Package
    - [33]
  - I recommend we discuss the relative weighting of the draft capital package, the trade-offs required to remain with the capital allowance and what changes you would like to see for the near final version for Budget Ministers 3 on Monday 26 March.

# Budget Responsibility Rules

- Managing within the Budget 2018 allowances of \$2.6 billion operating and \$3.4 billion capital signalled in the 2018 Budget Policy Statement will help the Government remain on track to meet our Budget Responsibility Rules.
- The Treasury's Half Year Economic and Fiscal Update (HYEFU) expected net core Crown debt to fall to 19.3% of GDP by 2021/22.
- Since the HYEFU key economic indicators are broadly tracking to Treasury's expectations. The most recent month-end results show the Government's books are tracking ahead of the Treasury's expectations at HYEFU, largely on the back of stronger tax outturns.
- Any additional fiscal headroom (compared to the HYEFU) will need to be carefully managed. In particular smaller operating allowances beyond 2018 and risks being weighted to the downside (refer slides 14 and 15) may provide challenges in meeting our Budget Responsibility Rules.
- The material for Budget Ministers 3 will include an update on the economic and fiscal forecasts.

# Risks Beyond Budget 2018

With a significantly smaller operating allowance beyond 2018 and some large pre-commitments already charged against future capital allowances managing within allowances will be challenging, in particular with the following risks:

- **Cost pressures** – Over the last four Budgets on average around 60% of the operating Budget package has comprised funding to address cost pressures. The Budget 2018 draft package follows a similar trend with around 70% of the package relating to cost pressure initiatives. In addition data provided in Departments' 4 year plans identify continued cost pressures.
- **Capital pipeline** – Information on the capital pipeline suggests that capital intentions are significantly higher than the capital allowances.
- **Manifesto commitments** – Around \$1.6 billion of operating and around \$3.7 billion of capital manifesto initiatives submitted for Budget 2018 have not been supported in the draft package, so may need to be considered in future Budgets. In addition there are a number of manifesto commitments that have not come through for consideration in Budget 2018 and there are also a number of reviews that may result in fiscal impacts (for example, national standards review and the welfare working group).

# Risks Beyond Budget 2018 (continued)

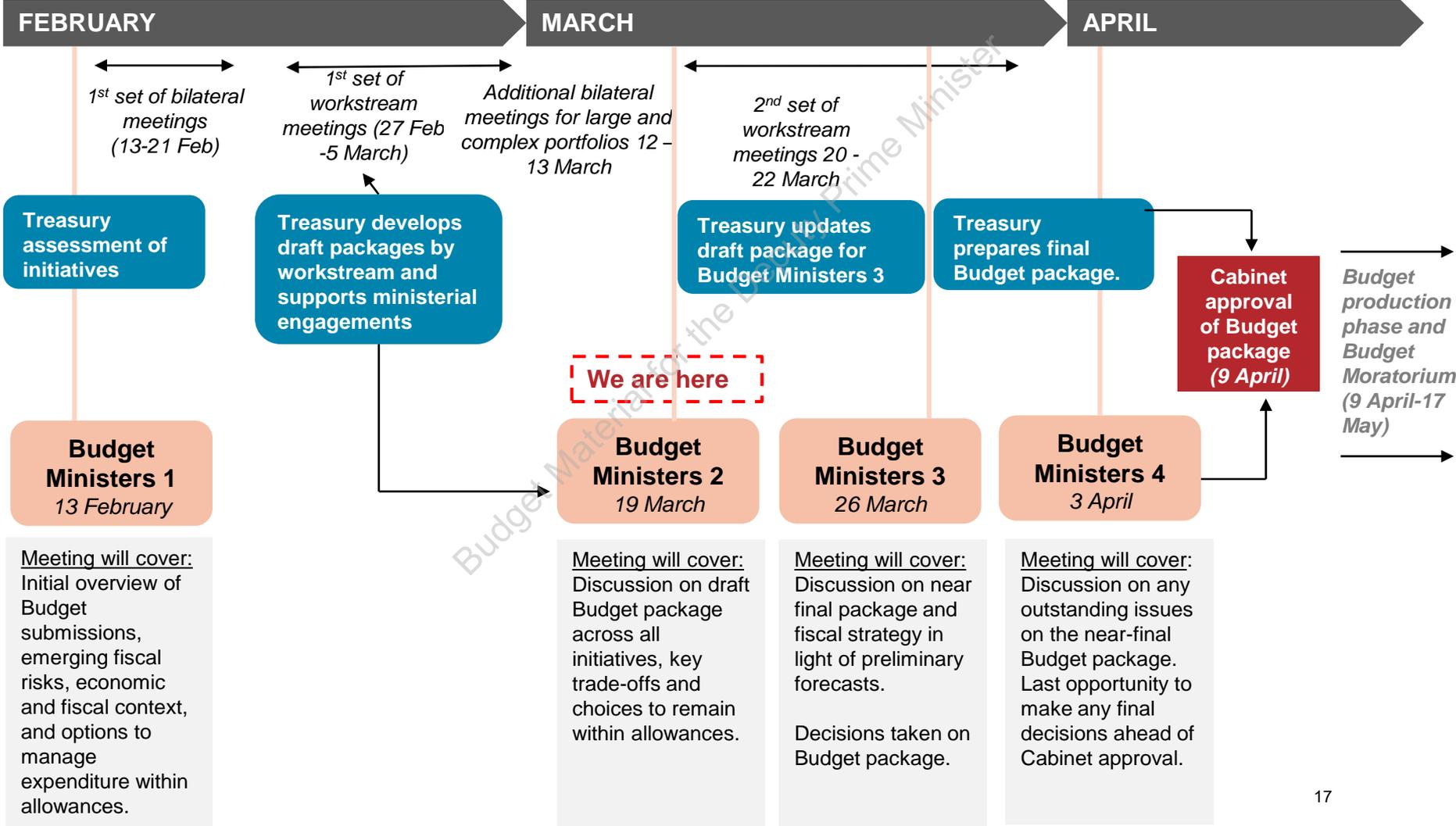
- **Pay equity settlements** – The Treasury has recently completed a high level estimate of the financial risk from pay equity settlements, both for the government and across the economy in general. The out-year cost of a <sup>[38]</sup> wage settlement (reflecting anecdotal international evidence) across all identified occupations was estimated to cost between <sup>[38]</sup> per annum for state-employed workforces. The out-year cost of a <sup>[38]</sup> wage settlement (reflecting the out-year wage increase of the Care and Support Workforce settlement) across all identified occupations was estimated to cost <sup>[38]</sup> annually for state-employed workforces. The cost of any wage settlements for state-funded workforces (e.g. Care and Support workforces) would be additional to these estimates.
- **Housing New Zealand** – The Government will need to consider how funding is provided to Housing New Zealand to support the acquisition of housing stock. If funded centrally rather than through HNZC borrowing it will need to be managed through the Budget allowances.

In addition there are risks to the Treasury's economic forecasts that could impact on the fiscal outlook. For example the Treasury's forecasts assume a fairly stable outlook for world growth, with growth in our top 16 trading partners in the 3.5% to 3.8% range throughout the forecast period. Should the global economy significantly deviate from this assumption, the New Zealand economy would be impacted via a range of channels, including demand for exports, global commodity price movements and shifts in financial conditions and asset prices. It is also worth noting that the Treasury's forecasts for real GDP growth are above the median of private sector forecasters.

# Non-spending or Regulatory Initiatives

- At Budget Ministers 1, Ministers sought advice from the Treasury on potential regulatory or policy changes which can be announced on Budget Day that don't have associated fiscal costs.
- The Treasury has identified non-spending or regulatory initiatives that could be ready for announcement as a part of the Budget 2018 package. They align with emerging priorities for economic strategy (which will be discussed shortly by the Cabinet Economic Development Committee) and/or the Budget 2018 priorities:
  - **Urban Growth Agenda:** work is underway to establish a programme of work over the medium to long term which creates the conditions for the market to respond to growth, bring down the high cost of urban land to improve housing affordability and support thriving communities. It will be focussed around five pillars: infrastructure funding and financing; pro-growth planning; Auckland development strategy and spatial planning; transport pricing (including congestion road pricing); and system coherence and long-term reform.
  - **Building sector productivity and innovation:** making improvements to the building and construction regulatory system to improve consenting processes and support use of more innovative and productive building techniques and materials.
  - **Housing – tenancy and tenure:** improvements to the residential tenancy system to lift the quality of rentals and provide greater stability of tenure.
  - **New progressive and inclusive trade agenda:** rebuilding public consensus around trade policy and the Government's objectives for trade.
  - **Reform of Reserve Bank's financial policy:** providing more detail on the second phase of the review of the Reserve Bank of New Zealand Act.
  - **Productivity Commission inquiry topics:** new inquiry topics are about to be selected for the Productivity Commission. The current short-list aligns with the direction of economic strategy and in some cases Budget 2018 priorities.
  - **Future of work:** announce the establishment of a Tripartite group of business, unions and government to support implementation of recommendations in the Future of Work.
- These initiatives could support broader messaging on the key outcomes and results that the Government wants to achieve from economic strategy by highlighting some of the initial areas of focus.
- Other initiatives were considered, but the initial assessment was that they were not ready for an announcements to be made around Budget 2018. Ministers may have other initiatives that could also be announced as part of a non-spending package.
- The initiatives outlined above are yet to be tested with agencies/Ministers. If Budget Ministers agree, a more detailed package will be pulled together.

# Next Steps



# Annex 1: Budget 2018 Draft Package by Portfolio and comparison to Budget 2017

The table below compares Budget 2018 Draft Operating Package with Budget 2017 Final Allocations (\$ million, average per annum)

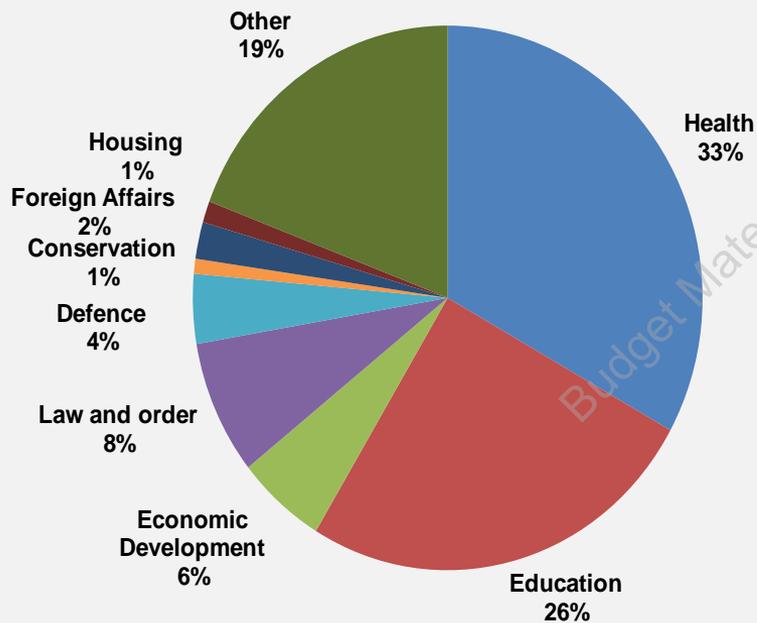
(\$million, average operating per annum) Portfolio	Budget 2017 final allocation*	Budget 2018 Draft Package
Conservation	16.677	38.905
Corrections	174.333	151.872
Defence	112.181	84.705
Education	314.500	[33]
Foreign Affairs	25.952	222.958
Health	563.000	770.801
Housing and Urban Development	75.007	139.797
Other portfolios	522.000	845.000

\* These numbers are based on the Budget 2017 Summary of Initiatives document, which includes a breakdown of funding by Vote. These Votes have been aligned with the new portfolio structure where feasible, but may not reflect a one-for-one alignment.

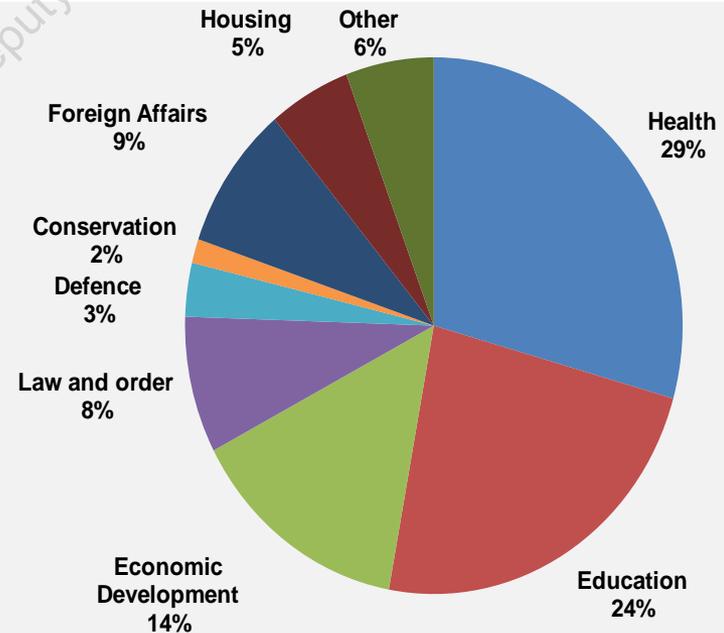
# Annex 2: Budget 2018 Draft Package comparison to base spending

The below figures compares the draft package against core Crown expenses forecast in the HYEUFU for the 2017/18 fiscal year.

Core Crown expenses (excluding finance costs and social security and welfare expenses)



Draft operating package broken down by core Crown expense classifications



# Annex 3: Core Crown expenses

Core Crown expenses (excluding finance costs) over the last 10 years have increased on average by around 3.8% per annum.

## Historical series of core Crown expenses (including forecasts for 2018 based on HYEFU)

(\$millions)	2008 Actual	2009 Actual	2010 Actual	2011 Actual	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Forecast
Social security and welfare	17,730	19,189	20,814	21,724	21,956	22,459	23,026	23,523	24,081	25,294	26,191
Health	11,297	12,368	13,128	13,753	14,160	14,498	14,898	15,058	15,626	16,223	17,184
Education	9,551	11,455	11,724	11,650	11,654	12,504	12,300	12,879	13,158	13,281	14,397
Core government services	3,371	5,293	2,974	5,563	5,428	4,294	4,502	4,134	4,102	3,957	5,477
Law and order	2,797	2,992	3,103	3,312	3,338	3,394	3,463	3,515	3,648	3,882	4,146
Transport and communications	2,244	2,663	2,345	2,281	2,232	2,255	2,237	2,291	2,178	2,176	2,486
Economic and industrial services	2,889	2,960	2,806	2,542	2,073	1,978	2,058	2,228	2,107	2,544	2,941
Defence	1,562	1,757	1,814	1,809	1,736	1,804	1,811	1,961	2,026	2,146	2,318
Heritage, culture and recreation	561	586	630	741	863	804	842	778	787	850	879
Primary services	541	534	507	706	648	659	676	667	749	644	792
Housing and community development	260	297	339	943	( 46)	283	347	320	558	539	662
Environmental protection	546	416	651	1,225	769	530	533	723	587	871	1,291
GSF pension expenses	690	655	328	305	192	278	282	358	271	217	150
Other	254	117	80	479	425	603	579	145	461	181	412
Finance costs	2,460	2,429	2,311	3,066	3,511	3,619	3,620	3,783	3,590	3,534	3,513
Forecast new operating spending	..	..	..	..	..	..	..	..	..	..	179
Top-down expense adjustment	..	..	..	..	..	..	..	..	..	..	( 1,365)
<b>Core Crown expenses</b>	<b>56,753</b>	<b>63,711</b>	<b>63,554</b>	<b>70,099</b>	<b>68,939</b>	<b>69,962</b>	<b>71,174</b>	<b>72,363</b>	<b>73,929</b>	<b>76,339</b>	<b>81,653</b>