

The Treasury

Budget 2018 Information Release

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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.

Chair
Cabinet

BUDGET 2018

Proposal

1. This paper seeks approval of the Budget 2018 package.

Executive Summary

2. Investment in Budget 2018 supports the following key priorities:
 - a. Providing quality public services for all New Zealanders and improving access to core services such as health and education.
 - b. Taking action on child poverty and homelessness.
 - c. Supporting families to get ahead and sharing the wealth generated by our economy with a wide range of New Zealanders.
 - d. Sustaining economic development and supporting the regions.
 - e. Managing our natural resources and taking action against environmental challenges, such as climate change.
3. The overall package builds on the investments made in the pre-Christmas 'mini-Budget' and reflects significant investment to rebuild underfunded public services, meet the needs of a growing population, provide significant funding to support economic development and the regions, and support families to get ahead.
4. This Budget is delivered against a backdrop of underfunding of core public services for the last nine years. This is particularly clear in areas such as health and education where funding has simply not kept up with population increases or other cost pressures. Baseline funding in a number of areas has stayed static which has led to a build-up of cost pressures that now cannot be ignored.
5. The outlook for the New Zealand economy continues to be positive with growth over the next four years expected to average around 3% per year. Productive economic growth is expected to drive a fall in unemployment to the Government's target rate of 4% by 2020/21. This combined with stronger tax outturns means the Government is on track to meet its Budget Responsibility Rules, which has been a key anchor underpinning decisions in Budget 2018.

6. In the 2018 Budget Policy Statement (BPS) last year, we signalled an operating allowance of \$2.600 billion per annum and a capital allowance of \$3.400 billion. Funding sought through Budget 2018 significantly exceeded those allowances.
7. To help meet the cost pressures we are facing I am proposing to increase both the Budget 2018 operating allowance to \$2.848 billion per annum and the Budget 2018 capital allowance to \$3.804 billion. These are in addition to the investments already accounted for as part of the 100 Day Plan. This will allow the Government to meet key manifesto commitments and make investments to support the key priority areas mentioned above to support our growing economy.
8. To help manage emerging pressures such as agency cost pressures that reflect historic underfunding of core services, outstanding manifesto commitments, and possible significant fiscal implications such as pay equity settlements I am proposing to increase the operating and capital allowances from Budget 2019 onwards. Operating allowances for Budgets 2019-2021 will be increased to \$2.4 billion and capital allowances will be increased to \$3.7 billion in Budget 2019, \$3.4 billion in Budget 2020 and \$3.0 billion in Budget 2021.
9. New investment provided through the Budget 2018 operating and capital packages is outlined in Table 1.

Table 1: Budget 2018 Package by Key Portfolios

\$million	Final Operating Package (average per annum)	Final Capital Package (Total)
Conservation	45.405	-
Corrections	[38]	
Defence	84.705	41.311
Education	[33], [37], [38]	411.481
Foreign Affairs	246.203	40.281
Health	[33], [38]	
Housing and Urban Development	122.931	369.351
Police	[38]	17.800
Research, Science and Innovation	274.433	11.925
Other Portfolios*	186.620	1,790.94
Total	[33], [37], [38]	

* The 'Other Portfolios' row also includes Budget 2018 pre-commitments, funding set aside for the between-Budget contingency, and the Provincial Growth Fund for Budget 2018.

10. Table 2 below provides a breakdown of how the overall capital and operating packages above reflect funding for the Provincial Growth Fund of \$1.0 billion total funding.

Table 2: Breakdown of Provincial Growth Fund

Provincial Growth Fund	
Operating funding (\$m)	Year 1 Total
Existing operating funding	135
Budget 2018 funding	549
Total operating	684
Capital funding (\$m)	Year 1 Total
Existing capital funding	80
Budget 2018 funding	236
Total capital	316
Total operating and capital	1,000

11. The \$2.848 billion operating package is net of any savings and reprioritisation. The revenue measures included in the Budget 2018 operating package total \$208 million per annum and relate to increased tax revenue from Inland Revenue compliance activity, a new model for collection of GST on low value goods and loss ring fencing. In addition, the operating package includes reprioritisation of \$174 million per annum. This reflects funding for low value activities and those that are not aligned to this Government's priorities. I expect that future Budgets will continue the focus on reprioritisation, with a deep dive into large and complex Votes to ensure current spending provides value for money and identify options for redeploying funding that is ineffective.
12. The funding in Budget 2018 is in addition to the \$13.3 billion of total expenditure delivered through our 100 Day Plan. This included \$5.5 billion for the Families Package, which will be a centre-piece on Budget day. The 100 Day Plan has gone a long way towards reducing inequality and poverty and investing for the long term benefit of New Zealand but there is still plenty of work to be done.
13. Annex 1 includes a list of all initiatives in the Budget 2018 package. Also attached to this Cabinet paper is the significant financial recommendations to appropriate funding into baselines. These recommendations have been developed in consultation with agencies.

Economic and Fiscal Conditions

The Economic and Fiscal outlooks remain positive

14. The outlook for the New Zealand economy continues to be positive with growth over the next four years expected to average around 3% per year. The range over the forecast period represents a shift away from growth driven by population increases and housing speculation to one based more on increasing investment in productivity and fairer distribution of prosperity.

15. The broad drivers influencing the growth outlook remain similar to those in the *Half Year Economic and Fiscal Update (HYEFU)*. Migration continues to add to the population and therefore economic activity but is assumed to ease and therefore provide less of a growth impetus over time. Similarly, low interest rates are stimulatory in the short term but begin to rise from 2019, providing less growth impetus. The Families Package supports household incomes from the second half of 2018, supporting household spending. KiwiBuild contributes to an acceleration in residential investment, particularly in the second half of the forecast period.
16. Productive economic growth is expected to drive a fall in unemployment to the Government's target rate of 4% by 2020/21. Wages are forecast to grow at just over 3% on average over the next four years, reaching 3.3% growth in 2021/22 – a real terms rate of growth of 1.1%.
17. The most recent month-end financial results show the Government's books are in good shape and are tracking ahead of the Treasury's expectations at HYEFU, largely on the back of stronger tax outturns.
18. The strength in tax is expected to persist for the remainder of the current year and into the future. Coupled with the impact from the updated economic outlook, overall tax revenue is forecast to be cumulatively \$4.0 billion higher than HYEFU.
19. If we maintained the Budget allowances signalled in the 2018 BPS the Treasury's preliminary fiscal forecasts show an operating surplus of \$2.6 billion in the current year growing to \$9.9 billion by 2021/22 and net core Crown debt reducing to 18% of GDP by 2021/22 (see Table 3). As noted below, we are proposing revisions to those allowances that will alter this debt track.
20. The table below provides a summary of the key economic and fiscal indicators from the Treasury's preliminary Budget Economic and Fiscal Update (BEFU) forecasts.

Table 3: Summary of preliminary Economic and Fiscal forecasts

June years		2017	2018	2019	2020	2021	2022
		Actual	Forecast	Forecast	Forecast	Forecast	Forecast
Economic growth (annual average % change)	Prelim BEFU	3.3	2.9	3.3	3.5	2.8	2.3
	HYEFU	2.7	2.9	3.6	3.0	2.6	2.1
Economic growth per capita (annual average % change)	Prelim BEFU	1.2	0.9	1.3	1.9	1.4	1.1
	HYEFU	0.6	0.9	1.7	1.4	1.4	1.1
Unemployment rate (June quarter)	Prelim BEFU	4.8	4.6	4.3	4.1	4.0	4.1
	HYEFU	4.8	4.6	4.4	4.2	4.0	4.1
CPI inflation (annual % change)	Prelim BEFU	1.7	1.6	1.6	2.0	2.1	2.2
	HYEFU	1.7	2.0	1.9	2.1	2.2	2.2
Current account balance (annual as % of GDP)	Prelim BEFU	-2.8	-2.6	-3.0	-2.8	-3.0	-3.0
	HYEFU	-2.9	-2.1	-2.3	-2.7	-3.3	-3.9
\$billions							
Operating Balance Before Gains and Losses	Prelim BEFU	4.1	2.6	2.7	5.2	7.0	9.9
	HYEFU		2.5	2.8	5.0	6.5	8.8
Total Change			0.1	(0.1)	0.2	0.5	1.1
Core Crown revenue	Prelim BEFU	81.8	86.1	89.9	95.2	100.6	106.2
	HYEFU		84.7	89.5	94.6	100.0	105.0
Total Change			1.4	0.4	0.6	0.6	1.2
Core Crown expenses	Prelim BEFU	76.3	82.3	86.5	89.2	92.8	95.4
	HYEFU		81.7	86.3	89.2	92.7	95.3
Total Change			0.6	0.2	0.0	0.1	0.1
Residual cash	Prelim BEFU	2.6	(2.2)	(3.7)	(1.7)	0.1	3.7
	HYEFU		(2.6)	(4.7)	(2.6)	0.3	2.3
Total Change			0.4	1.0	0.9	(0.2)	1.4
Net core Crown Debt	Prelim BEFU	59.5	61.2	64.9	66.5	66.3	62.6
	HYEFU		62.1	66.8	69.4	69.0	66.8
Total Change			(0.9)	(1.9)	(2.9)	(2.7)	(4.2)
% of GDP							
Net core Crown Debt	Prelim BEFU	21.7	21.2	21.5	20.9	19.9	18.0
	HYEFU		21.7	22.2	21.9	20.8	19.3
Total Change			(0.5)	(0.7)	(1.0)	(0.9)	(1.3)

Allowing for increases in Budget allowances will help manage emerging pressures and risks...

21. The stronger fiscal outlook compared to HYEFU has provided some fiscal headroom to increase Budget allowances beyond 2018. The operating allowances for Budgets 2019 to 2021 are now \$2.4 billion (an increase of \$525 million from the December 2017 Budget Policy Statement). Capital allowances are \$3.7 billion for Budget 2019, \$3.4 billion for Budget 2020 and \$3.0 billion for Budget 2021 (an increase of \$300 million in each Budget).
22. The increase in Budget allowances will help the Government manage emerging pressures such as:
 - a. Agency cost pressures that are expected to continue, reflecting the historic underfunding of core services by the previous Government.
 - b. A number of significant capital projects (for example P8-A aircraft and Dunedin Hospital) that will require consideration in future Budgets.
 - c. Outstanding manifesto commitments that will need to be considered in future Budgets.
 - d. A number of reviews currently underway (for example the Welfare Expert Advisory Group) and other high priority areas (for example Wellbeing Budget) identified for future Budgets that may have fiscal implications.

- e. Possible significant fiscal implications in relation to resolving future pay equity settlements.

...while still meeting our Budget Responsibility Rules

- 23. Budget 2018 is consistent with the Government's Budget Responsibility Rules, in particular delivering a sustainable operating surplus across an economic cycle and reducing the level of net core Crown debt to 20% of GDP within five years of taking office.
- 24. Incorporating the increases in Budget allowances into the Treasury's preliminary fiscal forecasts, show that net core Crown debt in 2021/22 is likely to be broadly similar to what was forecast at the Half Year Update. The final fiscal forecasts for the Budget Economic and Fiscal Update are due to be completed on 26 April.
- 25. It is important that we maintain a small buffer against our debt target outlined in our Budget Responsibility Rules in case of any deterioration in the economic or fiscal forecasts or realisation of any fiscal risks.
- 26. A key risk for Cabinet to be aware of is the response to Mycoplasma Bovis. There is currently a high level of uncertainty around the amount of funding required for both 2017/18 and outyears, as there are still a number of options for Cabinet to consider when agreeing to a response. These options are highly likely to have significant fiscal and economic implications. Due to the current uncertainty around the funding required at this point, I propose to include a Specific Fiscal Risk in the Budget Economic and Fiscal Update. Once there is certainty around the funding required and Cabinet's policy response, it is likely that this funding will need to be pre-committed against Budget 2019.

Budget 2018 Strategy and Process

- 27. In December 2017, I brought a paper to Cabinet which set out the strategy, process and key expectations for Budget 2018 to ensure we deliver on our commitments.
- 28. The Budget 2018 package presented today is the culmination of robust assessment and a collaborative consultation and decision-making process.
- 29. The scope for Budget 2018 submissions was limited to significant operating and capital cost pressures and spending commitments set out in the Coalition Agreement, the Confidence and Supply Agreement, and the Speech from the Throne. To maximise the value of these commitments which we have made to New Zealanders and to ensure that they are implemented effectively and their success is measured, they were subject to the same information requirements and analysis as all other Budget initiatives.
- 30. This is only the Coalition Government's first Budget of the current term – there will be future opportunities to ensure all of the Coalition Agreement, Confidence and Supply Agreement and Speech from the Throne commitments are enacted as we make our way through our ambitious three-year work programme.

31. In order to support the prioritisation of initiatives, the Treasury developed a Red Amber Green (RAG) framework for both cost pressures and manifesto initiatives. This assisted us in making key trade-offs based on:
 - a. The risks and implications associated of not funding cost pressures, and
 - b. The scope, implementation readiness and accuracy of costing across manifesto initiatives.
32. To further support the development of a Budget package, we developed five workstreams which broadly align with the Cabinet Committee groupings. These are Social Wellbeing, Economic Development, Natural Resources, Infrastructure and Other. These workstreams enabled us to consider initiatives dealing with similar issues or sectors together and allowed workstream Ministers to identify priority initiatives across portfolios which fed into Budget Ministers' final decisions.

Budget 2018 Allowances and Context

33. Funding sought through Budget 2018 significantly exceeded the operating and capital allowances agreed to in the Budget Policy Statement last year. This continued the upward trend over the past few years, as essential funding pressures were ignored by the previous government.
34. To allow the Government to meet key manifesto commitments and make the necessary investments to rebuild the economy I propose to increase Budget 2018 and future Budget operating and capital allowances to the levels in Figure 1 and 2, while still meeting the Government's Budget Responsibility Rules.

Figure 1: Operating allowance changes from the 2018 Budget Policy Statement

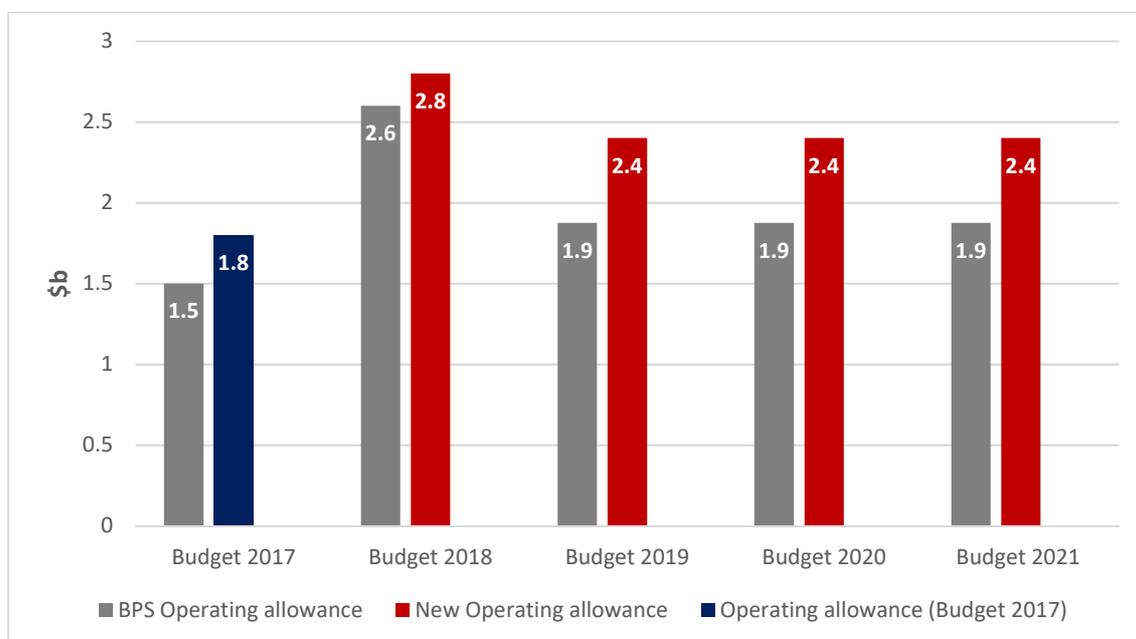
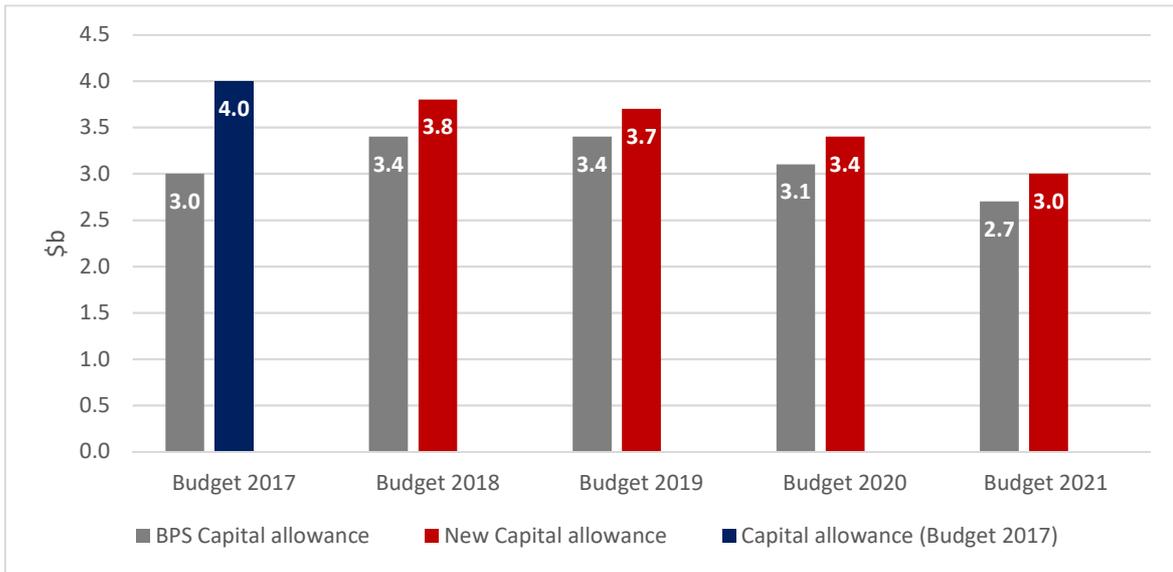


Figure 2: Capital allowance changes from the Budget Policy Statement



35. The Budget 2017 capital allowance was increased significantly due to Kaikoura related expenditure (around \$1 billion) and funding set aside in a contingency to support an increase in prison capacity (around \$763 million).
36. The new Budget allowances represent a significant increase in signalled spending compared to previous Budgets, as illustrated in Figures 3 and 4 below.

Figure 3: Operating allowance comparison 2009-2021

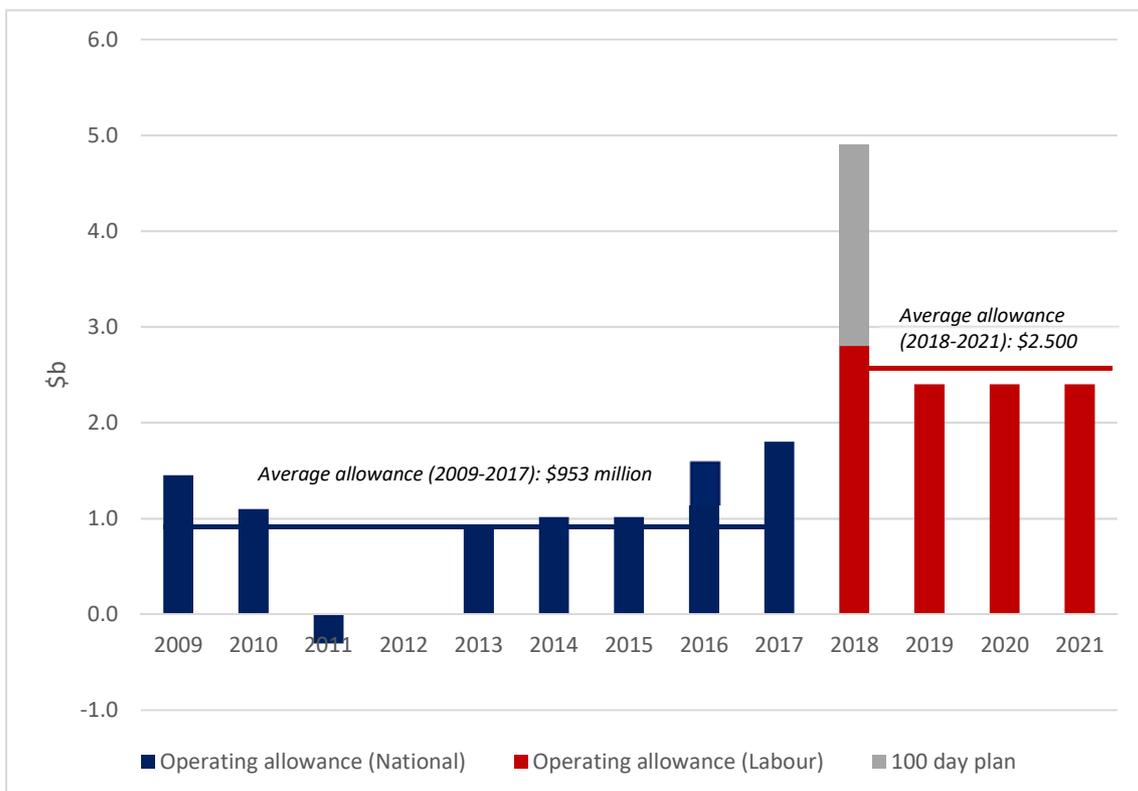
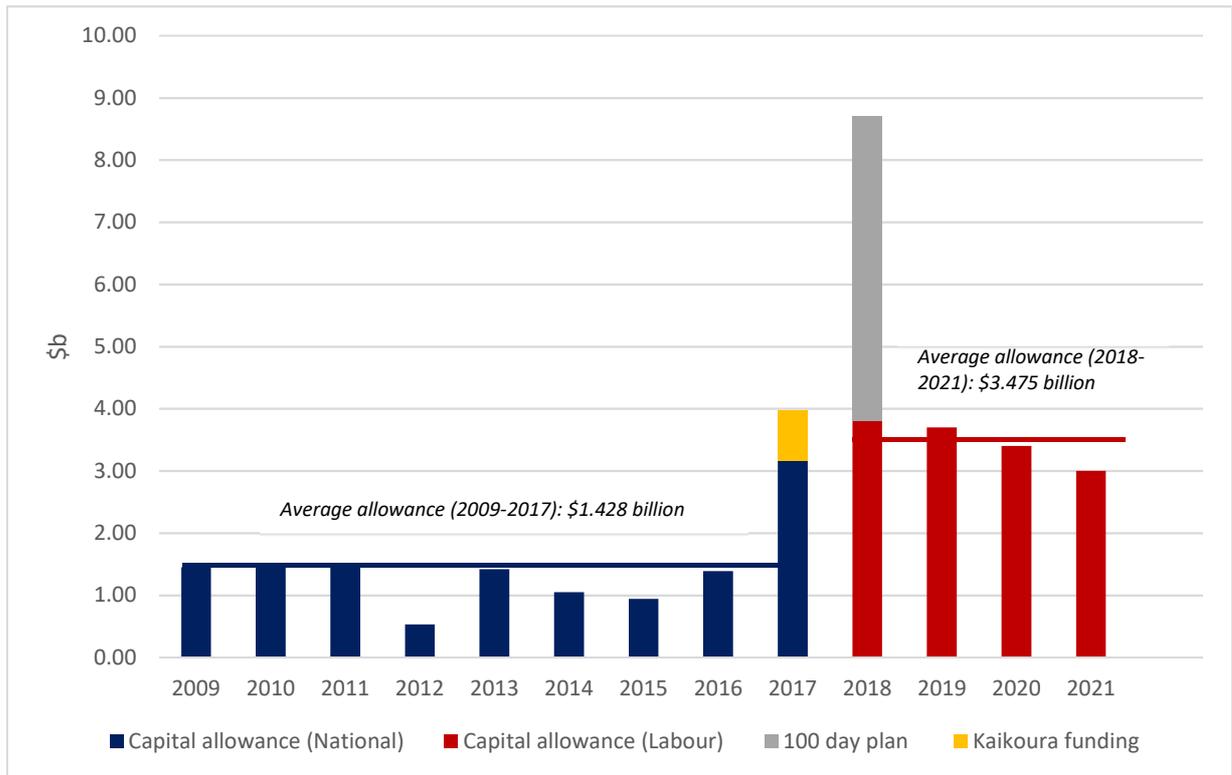


Figure 4: Capital allowance comparison 2009-2021



37. In addition, Budget 2018 allocates a significant amount of new funding in key areas in comparison to the Budget 2017 allocation as shown in Tables 4 and 5 below. These include:

- a. [33], [37], [38]
- b. a more than 30 per cent increase in the new operating funding available for Health and a significant increase in capital investment;
- c. near trebling of the new operating funding available to Conservation, in line with commitments in both the Coalition and Confidence and Supply Agreements;
- d. nearly doubling the new operational funding available for Housing and Urban Development;
- e. a 5 fold increase in the new operational funding available for Research, Science and Innovation; and
- f. a significant increase in funding for Foreign Affairs, in particular the provision of Official Development Assistance.

Table 4: Operating expenditure by key portfolio – Budget 2017 vs. Budget 2018

Operating expenditure per annum by key portfolio B17 vs B18 (\$m)			
	Budget 2017	Budget 2018	Difference
Health	563	[33]	
Education	315	[33], [37], [38]	
Conservation	17	45	28
Foreign Affairs	26	246	220
Housing and Urban Development	75	123	48
Research, Science and Innovation	51	274	223
Other ¹	757	550	-206
TOTAL	1804	[33], [37], [38]	

¹Note that Other includes funding for the Provincial Growth Fund for Budget 2018, amounting total funding to \$1 billion.

Table 5: New Capital expenditure by key portfolio – Budget 2017 vs. Budget 2018

Capital expenditure by key portfolio B17 vs B18 (\$m)			
	Budget 2017	Budget 2018	Difference
Corrections ¹	763	[38]	
Education	392	411	19
Christchurch Regeneration	0	359	359
Health	150	[38]	
Housing and Urban Development ²	120	369	249
Infrastructure ³	0	300	300
Transport ⁴	1971	697	-1274
Other ⁵	379	547	168
TOTAL	3775	[38]	

¹Note that the Budget 2017 funding was put aside in a contingency for Waikeria.

²Note that funding for Budget 2018 does not include Kiwibuild as this was reflected at HYEPU through the 100 Day Plan

³Note that the funding for Budget 2018 reflects a precommitment for Crown Infrastructure Partners.

⁴Note that the transport funding includes \$812 million capital that was funded for the SH1 rebuild following the 2016 Earthquake.

⁵Note that Other includes funding for the Provincial Growth Fund for Budget 2018, amounting total funding to \$1 billion.

The Budget 2018 Package

38. The Budget 2018 package reflects the following key priorities:

Providing quality public services for all New Zealanders and improving access to core services such as health and education

39. A large proportion of the Budget 2018 package is for cost pressures and this reflects our commitment to rebuilding core public services. Our priority is to make the investments we need to bring our public services back up to the standard that New Zealanders expect and deserve. Budget 2018 includes funding for volume, price and wage pressures faced by agencies across key areas such as Health, Education and the Justice Sector. As outlined in Table 4 and 5 above, there is a significant increase in funding for core services compared to the Budget 2017 allocation.
40. The Government is committed to reversing the underfunding of core public services under the previous administration and this Budget has significantly progressed this commitment. This will be a large and important job and it will take more than one Budget to make up for nine years of neglect. The table below outlines the key areas of expenditure in Budget 2018 related to this priority.

Key Budget 2018 initiatives relating to this priority	
<p>Education [38] operating over four years, \$411 million capital)</p>	<p>The Budget 2018 Education package builds on the significant Tertiary Package of \$2.6 billion made through our 100 Day Plan. Overall, the Education package is heavily weighted towards meeting cost pressures and demographic changes under current economic and policy settings. This includes supporting price and volume pressures as a result of growth in school rolls, Early Childhood Education (ECE) subsidies and teacher salaries (\$984 million over the forecast period). These forecast changes have been higher than in previous Budgets mainly due to stronger migration.</p> <p>The package also includes a 1.6% across-the-board price adjustment for the school operations grant and ECE subsidies (\$182 million over the forecast period). This is consistent with inflation growth and reflects the first universal price increase for all components of ECE subsidies since 2008.</p> <p>Funding is also provided to meet increasing demand for learning support services such as the Ongoing Resourcing System and English for Speaker of Other Languages (\$284 million over the forecast period). This funding addresses both higher numbers and higher needs, including by reducing waiting lists in the Early Intervention Service where there has been no increase to the number of children the service is funded to support since 2007.</p> <p>In addition to cost pressures, this package includes funding for developing new measures of children's progress in schooling, increasing teacher supply and commencing consultation with key stakeholders the 30 year education strategy and review of Tomorrow's Schools.</p>

	<p>The capital investment primarily supports the Schools Growth Package, which delivers new schools, expansions of existing schools, and additional classrooms to schools across the country to meet roll growth. The funding also provides a capital contribution to the Christchurch Schools Rebuild programme for 2018/19.</p>
<p>Health [33], [38] operating over four years, [33], [38] million capital)</p>	<p>The Health package is primarily driven by an increase of \$2.2 billion for District Health Board (DHB) cost pressures over the forecast period. This compares to \$1.8 billion for DHB pressures funded through Budget 2017, which included a 0.75% efficiency dividend requiring further cuts to be made by DHBs already struggling. In addition, Budget 2018 meets volume and price, and wage pressures across a number of core health services including: maternity services, disability support, air ambulances and continuing the roll out of the bowel screening programme (\$482 million over forecast period).</p> <p>As well as meeting cost pressures, Budget 2018 progresses a significant primary care package (totalling \$426 million over the forecast period) including implementing very low cost GP visits for community service card holders and extending zero fee doctor visits to under 14s. This will reduce access barriers in the health system, and begin to address health inequities and improve health outcomes. The Government intends to make further investments in primary care following the primary care review.</p> <p>The capital investment primarily supports a wide range of DHB Capital Investments to expand service capacity and replace sub-standard facilities, and in the process improve patient experience and outcomes. Funding for the design costs of the Dunedin Hospital redevelopment is also provided.</p>
<p>Justice Sector (\$1.3 billion operating over four years, [38] million capital)</p>	<p>There is increasing demand on the justice pipeline and Budget 2018 meets a number of cost pressures across the sector. This includes building capacity to manage increasing prisoner volumes, increasing the level of resources for community sentences, managing courts and coroner related pressures and building capability in the Ministry of Justice. Budget 2018 also meets the Government's commitment to increasing police numbers over time. A phased implementation will ensure the right people are recruited to support a safe and stable community.</p>
<p>Oranga Tamariki (\$388 million operating over four years)</p>	<p>The Ministry of Children, Oranga Tamariki was set up on 1 April 2017 and is dedicated to supporting children in New Zealand whose wellbeing is at significant risk of harm now, or in the future. Budget 2018 primarily supports Oranga Tamariki to build departmental capability to deliver on this objective and meet requirements under the Oranga Tamariki Act such as including 17 year olds in the Youth Justice system. Funding is also provided to reinstate the clothing allowance for children supported by the Orphan's Benefit or Unsupported Child's Benefit.</p>

<p>Social Development (\$217 million over four years and \$18 million capital)</p>	<p>A key focus of the social development portfolio is supporting vulnerable populations through family violence services, extending funding for KidsCan and extending the limited services volunteer programme. Family violence services have been underfunded in the past and are unable to cope with current demand. Budget 2018 provides funding to meet the uplift in demand and for evaluation of family violence services to inform future investment. Funding is also provided to meet the Government's commitment to overhaul the welfare system. The first step of this is setting up an expert welfare advisory group who will report back to the Government with recommendations.</p>
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41. There are also a number of initiatives in the Budget 2018 package which seek to build New Zealand's resilience in the face of natural disasters and hazards. This includes:
- a. \$35.251 million operating over four years and \$17.296 million capital to improve the Ministry for Social Development's critical systems resilience and enable them to return to normal operating for critical business functions within 4 hours of a disaster.
 - b. \$5.30 million over four years to support Kaikoura District Council's earthquake recovery in remediating natural hazards and repairing Three Waters assets, local roads and the harbour.
 - c. \$3.00 million over two years to respond to the problems identified in the first stage of the Three Waters Review and the Havelock North Inquiry Into Drinking Water.

Taking action on child poverty and homelessness

42. This government will put child poverty at the heart of government policy development and decision-making and the Government's investments so far (including as part of the 100 Day Plan) have made significant progress towards this commitment.
43. The Government has already set ambitious 10 year targets that will effectively halve the rate of child poverty using measured outlined in the Child Poverty Reduction Bill. The following three year targets will help keep us on track for reaching those 10 year targets and will help guide investment over the coming Budgets. These targets include:
- a. **Before housing cost measure:** reducing the proportion of children in low income households by 6 percentage points by 2020/21 – a reduction of around 70,000 children;
 - b. **After housing cost measure:** reducing the proportion of children in low income households by 4 percentage points by 2020/21 – a reduction of around 40,000 children
 - c. **Material hardship measure:** reducing the proportion of children in material hardship by 3 percentage points by 2020/21 – a reduction of around 30,000 children.

Key Budget 2018 initiatives relating to this priority	
<p>Housing (\$492 million operating over four years, \$369 million capital)</p>	<p>Housing is a top priority for this Government. It is a key foundation for New Zealanders getting ahead and achieving economic and financial independence, particularly those who are vulnerable. The primary focus of the Budget 2018 housing package is reducing homelessness and increasing accessibility to public housing.</p> <p>Funding is provided to continue and expand the Housing First initiative which supports chronic homelessness, support cost pressures associated with transitional housing and to increase the number of public housing places by at least 1,500 per annum. This will help improve access and support those in the highest need for housing. Funding is also provided to the Tamaki Redevelopment Company to support the regeneration of the area and increase the number of social and affordable housing.</p> <p>These investments are in addition to the Government's 100 Day Plan \$2.1bn commitment on Kiwibuild which focusses on increasing the number of affordable houses in New Zealand.</p>
<p>Child Poverty Unit and Measuring Child Poverty (\$34 million operating over four years)</p>	<p>Budget 2018 includes funding to set up a new Child Poverty Unit to implement the requirements set out in the Child Poverty Reduction Bill. Funding is also provided to Statistics New Zealand (\$20 million over four years) to significantly expand the current Household Economic Survey from 3,500 respondents to 20,000 help collect better information and allow more precise measures of child poverty in New Zealand. This is the first steps towards creating a work programme which will establish targets to reduce the impact of child poverty and hold the Government to account in meeting these targets.</p>

44. In addition to the Budget 2018 investments above, we have already made a significant investment towards this priority through the Families Package in our 100 Day Plan. The Families package will deliver more money to families with children and is expected to reduce the number of children in poverty by 64,000 by 2021. The package includes working for families' changes, a new Best Start payment to help families with children in early years, a winter energy payment and accommodation supplement increases to support those under housing stress.

Supporting families to get ahead and sharing the wealth generated by our economy with a wide range of New Zealanders

45. This Budget shares the benefits of our growing economy with a wide range of New Zealanders. We are lifting wages and giving genuine opportunities for pay equity. This builds on the policies already announced in the 100-Day Plan such as the Families Package and Kiwibuild.
- a. **Kiwibuild** (\$2.0 billion total capital): The establishment of Kiwibuild as part of the 100-Day Plan is a bold and ambitious programme which aims to facilitate the delivery of 100,000 affordable homes to first home buyers over the next 10 years. Crown funding will be leveraged with private (including iwi and institutional) investment, and be recycled as houses are sold.

- b. **Housing Commission** (\$100 million operating over four years): The Housing Commission will be responsible for driving the delivery of the KiwiBuild programme and undertaking major greenfield and urban redevelopment projects in partnership with councils, iwi and private developers.

46. In addition, Budget 2018 includes investment for the loss ring fencing initiative which will result in projected savings of \$325 million over the forecast period. This initiative will help level the playing-field between home buyers and investors by ring-fencing rental losses while also raising Government revenue to fund other Government priorities. Budget 2018 also includes funding for pay equity settlements and wage growth across key areas in the public sector. Further pay equity settlements are likely to be considered in coming Budgets.

Sustaining economic development and supporting the regions

Key Budget 2018 initiatives relating to this priority	
New model for collecting GST on low-value goods, and tax compliance activity additional revenue (\$401 million projected savings over four years)	These two initiatives will help ensure our tax system is efficient, fair, coherent and collects the tax that is due, by implementing a new model to collect GST on low-value imported goods (as recommended by the Tax Working Group) and increasing Inland Revenue activity to target non-compliant taxpayers.
Transport (\$697 million)	This funding will support KiwiRail's capital requirements for the national rail network. In particular, network maintenance and the purchase and refurbishment of rolling stock. [33] It also includes funding for the Auckland City Rail Link and reinstating the Main North Line.
Research, Science and Innovation (\$1.098 billion operating over four years and \$12 million capital).	This supports four initiatives, the majority of which relate to increasing Research and Development expenditure to two percent of GDP in 10 years. This includes \$1.024 billion operating funding for a Research and Development tax credit. It also includes \$57 million to support the delivery of a new bilateral 'Enhanced Partnership' with Singapore, and funding for delivering a National Research Information System to ensure that investment in research, science and innovation generates maximum benefits to New Zealand.
Provincial Growth Fund (\$1 billion, including pre-commitments and re-purposed funding)	The Provincial Growth Fund totals \$1 billion in its first year. <ul style="list-style-type: none"> • This is made up of funding of \$286 million from the operating allowance and \$88 million from the capital allowance. • In addition, a further \$111 million operating and \$49 million capital is funded from pre-commitments to Budget 2018. • Furthermore, \$135 million operating and \$80 million capital is funded from existing baselines. • The Provincial Growth Fund's funding for Budget 2018 also includes funding for: <ul style="list-style-type: none"> ○ One Billion Trees (which also contributes to the priority of managing our natural resources) <ul style="list-style-type: none"> ▪ \$132 million operating for Crown Forestry Planting, the Hill Country Erosion Programme and the Native Tree Planting ▪ \$89 million capital for Crown Forestry Planting ○ [33] <ul style="list-style-type: none"> ▪ \$10 million capital

	<ul style="list-style-type: none"> ○ [33] <ul style="list-style-type: none"> ▪ \$20 million operating • All together this equates to \$684m in operating and \$316m in capital expenditure
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Managing our natural resources and taking action against environmental challenges such as climate change

Key Budget 2018 initiatives relating to this priority	
<p>Conservation (\$182 million operating over four years)</p>	<p>This supports five initiatives, including a \$76 million tagged contingency for increasing the amount of funding to address biodiversity issues in the Conservation portfolio. Key initiatives include \$80 million for enhancing biodiversity by controlling and eradicating predators and \$16 million for strengthening the Department of Conservation’s organisational capability and capacity. Funding is also provided for managing visitor impacts and enhancing biodiversity by supporting community conservation.</p>
<p>Environment and Climate Change (52 million operating over four years and \$100 million capital)</p>	<p>This supports four initiatives in the Climate Change portfolio, totalling \$39 million operating and \$100 million capital. This funding includes the Green Investment Fund (\$25 million operating and \$100 million capital). It also includes funding for the establishment of an independent Climate Change Commission and further Climate Directorate Capability. This funding also supports three initiatives in the Environment portfolio, totalling \$13 million operating. These initiatives include funding to ensure that the Environmental Protection Authority’s core statutory functions can continue to be delivered, funding for a Resource Management Act Enforcement Oversight Unit, and funding for the Government’s response to PFAS contamination.</p>

Independent Fiscal Institution – discussion document announcement

47. As part of Budget 2018, I plan to announce that the Treasury will release a public discussion document in mid-2018 seeking views on the merits of an Independent Fiscal Institution and its potential roles. This announcement would be made through the 2018 Fiscal Strategy Report and any related press releases. The proposed discussion document takes forward the manifesto commitment made as part of the Budget Responsibility Rules to establish “an independent body who will be responsible for determining whether the Government is meeting its [Budget Responsibility] Rules.” This public engagement process will canvass the various roles and functions a new entity could undertake, with a particular focus on providing appropriate independent evaluation of fiscal policy and government forecasts, enhancing parliamentary scrutiny of fiscal policy, and costing of party-political policies. I will report back to Cabinet prior to the release of this discussion document.

Budget 2019 and beyond

Delivering a Wellbeing Budget in 2019

48. The Budget Policy Statement confirmed my intention to take a wellbeing approach to Budget 2019, which will support this Government's commitment to put people's wellbeing and the environment at the heart of our policies, including reporting against a wider set of wellbeing indicators in future Budgets.
49. The Budget provides an annual opportunity to review New Zealand's performance across some high-level indicators, place the Government's programme within the context of the economic and fiscal outlook, set out the Government's strategy for the future, and draw links to specific actions that have been, or will be, taken. It will be possible to introduce wellbeing considerations in each of these areas for Budget 2019.
50. I believe that the Wellbeing Budget is a key step in delivering on our objectives around:
 - a. broadening the scope of economic strategy to encourage wellbeing and sustainable growth, and setting high-level priorities against which we can measure progress and be held accountable;
 - b. using a wider range of indicators to understand our success as a country – broadly, wellbeing indicators augmenting GDP and fiscal aggregates (e.g. net debt);
 - c. framing priorities at the start of the Budget cycle, and driving more collaboration between agencies; and,
 - d. utilising good data and tools to assess initiatives for new spending (including a refined and revised Cost Benefit Analysis (CBAX) tool).
51. Cabinet Committees will have a central role in identifying some targeted priority areas for Budget 2019. Setting clear Budget priorities will help us to align the information requirements and initiative assessment process, which is managed by the Treasury, so that it supports the successful delivery of the Wellbeing Budget. This work will happen alongside wider work to agree a comprehensive set of wellbeing indicators that can be used to measure New Zealand's progress, being developed by Statistics New Zealand.
52. Changes for the wellbeing Budget will be announced later in the year, and detailed in Budget guidance to agencies, for example setting out how agencies could demonstrate that their initiatives align with wellbeing objectives. The emphasis will continue to be on demonstrating that initiatives will deliver particular objectives in a cost-effective way, anchored in our overarching wellbeing approach.

Reprioritisation

53. While reprioritisation has generated \$174 million per year to provide additional funding for Budget 2018, I intend that reprioritisation of funding should continue after Budget 2018. The objective for Phase Two of reprioritisation should focus on the effectiveness of existing expenditure, with the prospect that some or all of the savings identified may be reinvested in the portfolio under review. The shift to a Wellbeing Budget means that both marginal spending and savings should be considered as part of the Government's Wellbeing priorities.
54. There are three sequential objectives for Phase Two (and when Ministers commission the work, officials should be directed to address these three points):
 - a. Identify the spending which is least effective or has the weakest alignment with Government priorities and Wellbeing objectives
 - b. Identify options for redeploying that funding within the existing portfolio's baseline to produce a more effective spend, or outside of portfolio baseline which have higher government priority; and
 - c. Achieve an agreed forward baseline aligned with the Government's Wellbeing priorities which is sustainable over the cycle (including a possible medium term funding path being established, in line with possible reforms to the budget cycle process by alleviating cost pressures to provide greater funding certainty).
55. This year's Phase One reprioritisation reviews have confirmed that for material reprioritisation to be found from existing baselines, Ministers need to focus on the largest and most complex sectors. I will be working with Ministers to identify more focussed and defined areas for further work, including "deep dives" into some large and complex Votes.
56. I will be presenting a paper on the Phase Two work programme to the Cabinet Government Administration and Expenditure Control Committee (GOV) later in May.

Between Budget Spending

Between-Budget Contingency (BBC)

57. The Budget package includes a contingency for between-Budget operating spending averaging \$50 million per annum. This provides a buffer for any urgent matters that cannot wait until Budget 2019 and require funding in the 2018/19 financial year.
58. In line with Cabinet Office guidelines, Ministers should only seek funding from the between-Budget contingency for urgent issues that cannot be deferred. Such proposals should demonstrate that the initiative cannot be funded through reprioritisation of lower value activities. Proposals should not be submitted if the initiative could reasonably have been considered in this Budget, or that were previously considered and declined.

59. As urgent proposals are more likely to have funding requirements for the 2018/19 financial year, I propose that the profile of the between-Budget contingency includes a higher amount for the 2018/19 year as shown in table 6 below.

Table 6: Profile of between-Budget contingency

(\$ millions)	2018/19	2019/20	2020/21	2021/22 & Outyears	Total	Average over forecast period
Between-Budget Contingency (BBC)	80.000	40.000	40.000	40.000	200.000	50.000

60. Between-Budget proposals will be held to the same standards and requirements as initiatives submitted through the Budget process. Proposals must include a cost benefit analysis (using the CBAX model where appropriate) and demonstrate why they are urgent. Cabinet may provide exemptions to the requirement for cost benefit analysis where it would be impractical to undertake such analysis due to the urgency of a specific proposal [CAB-16-MIN-0307].

Tagged Contingencies

61. Funding for several initiatives has been set aside in tagged contingencies. Tagged contingencies are appropriate when Cabinet agrees with the policy direction but further work is required before Cabinet will agree to appropriate the funding (for example, the completion of a business case). Tagged contingencies are also used in circumstances where an initiative is commercially sensitive or negotiations have yet to take place (for example, State Sector wage negotiations).
62. Unless otherwise agreed tagged contingencies expire on 1 February the year after they are established. On occasion the expiry date of a tagged contingency needs to be extended, currently Cabinet approval is required for an extension. I propose to change the authority required to extend the expiry date from Cabinet to Joint Ministers (myself and the Minister(s) responsible for the tagged contingency).

Moratorium on Papers with Financial Implications

63. Once the Budget 2018 package has been agreed by Cabinet, production of the Budget documents must be completed. In order to ensure that the documentation tabled in the House of Representatives on Budget Day is accurate, Ministers cannot submit papers that have fiscal and/or appropriation implications for agreement by Cabinet Committees, Cabinet or Joint Ministers between now and Thursday 17 May 2018.

Consultation

64. This paper was prepared by the Treasury. The Budget package has been developed in line with the overall strategy agreed by Cabinet in December 2017, submissions in Four Year Plans, separate Cabinet consideration of some proposals, and a series of meetings between Ministers.

65. The New Zealand First and Green parties have been consulted on this Budget package.

Legislative Implications

66. The Appropriation (2018/19 Estimates) Bill, the Appropriation (2017/18 Supplementary Estimates) Bill, the Imprest Supply (First for 2018/19) Bill and the Imprest Supply (Second for 2018/19) Bill will give effect to Budget 2018.
67. No other legislation will be required to give effect to Budget 2018 initiatives as substantive legislation was passed or is currently before the House in relation to the 100 Day Plan.

Regulatory Impact Analysis

68. There are no regulatory requirements for this paper.

Publicity

69. Budget Day is Thursday 17 May. The Office of the Minister of Finance coordinates all communications relating to Budget 2018, including requests for early announcements. Written approval from the Prime Minister and The Minister of Finance is required for any early announcements.

Recommendations

70. I recommend that Cabinet:
- 1 **note** that Budget 2018 supports investment in the following key priorities:
 - a. Providing quality public services for all New Zealanders and improving access to core services such as health and education;
 - b. Taking action on child poverty and homelessness;
 - c. Supporting families to get ahead and sharing the wealth generated by our economy with a wide range of New Zealanders;
 - d. Sustaining economic development and supporting the regions, and
 - e. Managing our natural resources and taking action against environmental challenges such as climate change.

Economic and Fiscal Conditions

- 2 **note** that the Treasury's preliminary economic and fiscal forecast shows a positive outlook, with growth over the next four years expected to increase at an average of 3% per year;

- 3 **note** that final economic and fiscal forecasts for the Budget Economic and Fiscal Update are to be completed by Tuesday 10 April and Thursday 26 April respectively;
- 4 **note** that the most recent month-end financial results show the Government's books are tracking ahead of the Treasury's expectations at the Half-Year Economic and Fiscal Update, largely on the back of stronger tax outturns;
- 5 **Note** that this strength in tax is expected to persist for the remainder of the current year, and into the future;
- 6 **note** that overall tax revenue in the Treasury's preliminary forecasts is expected to be cumulative \$4.0 billion higher than the Half Year Economic and Fiscal Update;
- 7 **note** that if we maintained the Budget allowances signalled in the 2018 Budget Policy Statements (BPS) the Treasury's preliminary forecasts show net core Crown debt reducing to 18% of GDP by 2021/22;
- 8 **note** that this stronger fiscal outlook provides some fiscal headroom to increase Budget allowances beyond Budget 2018 and still meet our Budget Responsibility Rules;
- 9 **agree** to increase the capital and operating allowances for Budgets 2019 to 2021 as follows:

Operating	2019/20	2020/21	2021/22
Budget 2019	\$2.4b	\$2.4b	\$2.4b
Budget 2020	-	\$2.4b	\$2.4b
Budget 2021	-	-	\$2.4b

Capital	Total
Budget 2019	\$3.7b
Budget 2020	\$3.4b
Budget 2021	\$3.0b

- 10 **note** that these increases in Budget allowances will help the Government manage emerging pressures such as agency cost pressures reflecting historic underfunding of core services, outstanding manifesto commitments, significant fiscal implications resulting from current reviews and possible significant fiscal implications such as pay equity settlements;
- 11 **note** that Budget 2018 remains consistent with the Government's Budget Responsibility Rules of delivering sustainable operating surplus across an

economic cycle and reducing the level of net core Crown debt to 20% of GDP within five years of taking office.

- 12 **note** that it is important to maintain a small buffer against our debt target outlined in our Budget Responsibility Rules in case of any deterioration in the economic or fiscal forecasts or the realisation of any fiscal risks, and
- 13 **authorise** the Minister of Finance to finalise the fiscal priorities and future allowances for inclusion into the Fiscal Strategy Report.

Budget 2018 Package

- 14 **note** that the Budget 2018 package reflects significant investment to rebuild underfunded public services, meet the needs of a growing population, support economic development and the regions and supports families to get ahead;
- 15 **note** that in the Budget Policy Statement, we agreed to set aside an operating allowance of \$2.6 billion per annum for operating and \$3.4 billion for capital;
- 16 **note** that funding sought through Budget 2018 significantly exceeded those allowances;
- 17 **note** that new operating spending proposals in Budget 2018, net of any savings, revenue and reprioritisation, result in an increase of \$2.848 billion per annum on average over the forecast period;
- 18 **note** that new capital investment, net of any savings and reprioritisation, totals \$3.804 billion;
- 19 **note** that this will allow the Government to meet key manifesto commitments and make investments to support the key priority areas mentioned above to support our growing economy;
- 20 **agree** to the following final operating and capital packages, including reprioritisation and savings initiatives, as set out in the financial recommendations accompanying this paper;
 - a. a net operating package of \$2.848 billion per annum;
 - b. a net capital package of \$3.804 billion;
- 21 **note** that the significant financial recommendations have been developed in consultation with agencies;

- 22 **agree** that expenses or capital expenditure against appropriations and capital injection authorisations set out in the 2018/19 Estimates and being sought in that Bill may be met from Imprest Supply until the Appropriation (2017/18 Estimates) Bill is enacted; and
- 23 **authorise** the Minister of Finance and relevant Appropriation Ministers to approve changes to initiatives and appropriations where this proves necessary to finalise the 2018 Budget package.

Reprioritisation

- 24 **note** that \$174 million per annum operating and \$3.0 million capital has been identified as reprioritisation for Budget 2018 and has been reflected in the net operating and capital packages;
- 25 **note** that I will be presenting a paper on the Phase Two work programme to the Cabinet Government Administration and Expenditure Control Committee (GOV) later in May.

General Matters

- 26 **agree** to a between-Budget contingency of \$50 million per annum on average for operating expenditure, with the following profile:

(\$ millions)			
2018/19	2019/20	2020/21	2021/22 & Outyears
80.000	40.000	40.000	40.000

- 27 **agree** that:
- c. proposals for funding from the between-Budget contingencies must be for urgent issues that cannot be deferred to Budget 2019; and
 - d. Ministers will be expected to demonstrate that they have exhausted their search for opportunities to fund the initiative through reprioritisation of lower value activities;
- 28 **agree** to reprioritise the remaining \$4 million available in the Budget 2017 between Budget contingency, noting that this has been reflected in the overall reprioritisation amount;
- 29 **note** that Cabinet approval is currently required to extend the expiry date of a tagged contingency;
- 30 **agree** that Joint Ministers can extend the expiry date of a tagged contingency;
- 31 **agree** that no papers with fiscal and/or appropriation implications for agreement by Cabinet or Cabinet committees be submitted between 9 April 2019 and 17 May 2018 so that Budget documentation is accurate;

- 32 **note** that all communications relating to Budget 2018 are coordinated by a Budget communications committee, and that any requests for early announcement will need to have both the written approval of the Minister of Finance and sign-off from the Prime Minister's office; and
- 33 **invite** the Minister of Finance to introduce the Appropriation (2018/19 Estimates) Bill, the Appropriation (2017/18 Supplementary Estimates) Bill, the Imprest Supply (First for 2018/19) Bill and the Imprest Supply (Second for 2018/19) Bill to give effect to Budget 2018.
- 34 **note** that the Budget Responsibility Rules announced as part of the Labour and Green Parties 2017 Election manifesto included a commitment to establish an independent body that will be responsible for determining whether the Government is meeting its Budget Responsibility Rules as well as providing an independent assessment of government forecasts and costing policies of opposition parties;
- 35 **agree** that the 2018 Fiscal Strategy Report will announce the release of a public discussion document in mid-2018 seeking views on the merits of an Independent Fiscal Institution and its potential roles, and that I will report back to Cabinet prior to the release of this discussion document;

Hon Grant Robertson
Minister of Finance

Date: 9 April 2018