

The Treasury

Budget 2020 Information Release

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- [29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
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- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
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Treasury Report: Meeting with Minister of Defence - 3 March 2020

Date:	28 February 2020	Report No:	T2020/460
		File Number:	SH-14-1-1-0

Action sought

	Action sought	Deadline
Hon Grant Robertson Minister of Finance	<p>Note the alternative Defence funding packages outlined in this report.</p> <p>Note the suggested talking points for your meeting with the Minister of Defence.</p>	8.30am, Tuesday 3 March 2020

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Lucy Connell	Senior Analyst, Justice, Security and Government Services	[39]	N/A (mob)	✓
Colin Hall	Manager, Justice, Security and Government Services		[23]	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Meeting with Minister of Defence - 3 March 2020

Executive Summary

Following your 12 February meeting with the Minister of Defence on the Baseline Review, we have endeavoured to reach agreement with Defence on a Budget package for Ministers' consideration. We have been unable to reach agreement on:

- the final cost pressure package for Vote Defence Force, specifically the recommended funding for increases in personnel costs, and
- a recommended capital injection and depreciation allocation for the Defence Capability Plan (DCP) new spending initiative, and associated operating costs.

The New Zealand Defence Force (NZDF) has provided a revised "intermediate" cost pressure package that proposes a [33]

NZDF's revised option would provide NZDF with funding for FTE growth above the amount the Baseline Review determined is required to sustain current activity levels and to prepare for the introduction of new capabilities (i.e. funding FTE increases associated with yet to be approved investments included in the DCP).

Given the issues raised in the Baseline Review regarding NZDF's personnel cost structure, we consider it [33]

This principle underpins our proposed funding options, which seek to incentivise NZDF to urgently address its cost structure.

The following table outlines a range of cost pressure packages for NZDF and identifies Treasury's preferences.

Treasury Preference	Option	Four Year Cost (\$m)
[33]		[33]
		666
		[33]

Defence is now seeking capital funding from the Budget 2020 capital allowance of [33] compared to Treasury's proposal of \$898 million. Key differences relate to [33] purchased and the contribution to that purchase, and the proposed [33], from depreciation reserves.

Attached to this report is a table setting out in more detail Treasury and NZDF's proposed funding options for Vote Defence Force cost pressures and the DCP new spending initiative. The table also includes the recommended elements of the funding package agreed by both Defence and Treasury but excludes initiatives included [33]

Annex 1 provides suggested talking points for your meeting with the Minister of Defence.

Recommended Action

We recommend that you:

- a** **note** the alternative possible Budget 2020 cost pressure and new initiative packages for Defence and Treasury's and Defence's preferred options, and
- b** **note** the suggested talking points for your meeting with the Minister of Defence attached as Annex 1.

Colin Hall
Manager, Justice, Security and Government Services

Hon Grant Robertson
Minister of Finance

Treasury Report: Meeting with Minister of Defence - 3 March 2020

Purpose of Report

1. This report provides background information and some suggested talking points for your 3 March meeting with the Minister of Defence on Budget 2020 funding for Defence.

Analysis

2. We have agreed with Defence recommendations for Ministers on:
 - the Baseline Review “Option 3” funding track for Vote Defence cost pressures (\$6.368 million over four years), and
 - Vote Veterans cost pressures, in line with the Baseline Review recommendation ^[33] over four years).
3. We were not able to agree:
 - the final cost pressure package for Vote Defence Force, specifically the recommended funding for personnel costs, or
 - a recommended capital injection and depreciation allocation for the Defence Capability Plan (DCP) new spending initiative, and associated operating costs.

Vote Defence Force cost pressures

4. The following table sets out at a high level the current proposals for Vote Defence Force cost pressures across the forecast period.

Option	Description	\$m				Total
		20/21	21/22	22/23	23/24	
[33]						
[33]		141	165	176	183	666

5. Consistent with our earlier advice, we recommend you agree to our “Option B minus” option as it provides sufficient operating funding for Defence to sustain its current outputs, prioritises remediating Estate and ICT infrastructure, and prepares for the introduction of new capabilities.
6. [33,34]
7. NZDF has proposed a reduction of [33] [1] from the Baseline Review’s Option A. They have not provided specific detail on how this would be applied to the current package, except that its new ‘NZDF Intermediate Option’ involves:
 - [33] [1]
 - [33] of scaling from civilian positions, and
 - the remaining [33] would be found from reducing positions across NZDF HQ – NZDF has estimated a reduction in [33] may be possible, but have not yet determined how this would be achieved.
8. In addition to the NZDF option including [33], there is a [33] difference in the personnel costs between our [33]. We do not consider that NZDF has provided sufficient rationale as to why the additional FTE growth included in its option is necessary at this time given future capabilities, particularly in the [33], have yet to be approved or even fully scoped. Further, we question the achievability of this FTE growth in light of competing labour market demands.
9. NZDF has resisted previous attempts to make a concerted effort to address its escalating personnel costs, which were identified as an issue as early as 2015 during the Defence White Paper development. We consider that providing the additional funding for FTE growth at this time would eliminate a key incentive to address these costs.
10. We consider it is more appropriate to determine the personnel cost implications of new investments as part of the business case for capability proposals, rather than being considered through the Budget cost pressure process.
11. [34]

12. In summary, the table below shows our cascading recommendations for funding for NZDF cost pressures.

Treasury Preference	Option	Four Year Cost (\$m)
[33]		666
[33]		

Defence Capability Plan new spending initiative

13. At your meeting with the Minister of Defence on 12 February, Defence tabled a revised DCP funding proposal that reduced its capital funding request from [33]
. Our review of the proposal suggests that the revised proposal does not provide any significant concessions, other than increasing the contribution from depreciation reserves to the Hercules purchase in response to your feedback. [33]
14. Defence is currently seeking capital funding from the Budget 2020 capital allowance of [33] compared to Treasury's proposal of \$898 million. The differences between the two proposals is shown in the table below, with the difference impacting on the balance of depreciation reserves available to fund other, lower priority, Defence projects.

[illegible]

[33]

15. Our comments on the differences between the two proposals for the DCP new spending initiative are outlined below.

- [1]
and the proportion of depreciation allocated to offset the capital injections requirements. [1]

and that a higher amount of depreciation reserves should be allocated to this priority initiative.
- We have recommended that [33] is fully funded from depreciation reserves, given its priority to Defence, to recognise the significant Budget 2020 capital funding required for [33], and as we consider that, although it is investment ready, [33]
- We recommended reinstating [33] capital expenditure outlined in the original Budget initiative, [34]
- [33]

[33,34]

Next Steps

17. Attached are suggested talking points for your meeting with the Minister of Defence.
18. We have also attached an A3, which can be shared with the Minister, setting out the cost pressure and new spending proposals alongside the overall Defence Budget package.

[1]

Annex 1: Suggested talking points

- [33]
- It is also necessary to consider NZDF's cost pressures in the context of the full Defence funding package, ^[33]
The Defence capital initiative is also seeking a significant amount from the capital allowance.
- We must therefore strike a balance that provides sufficient funding for replacement of critical capabilities and to support Defence in achieving its current outputs.
- The Baseline Review highlighted significant issues with the current workforce structure, particularly the growth of civilian FTEs and salary costs.
- [33]
-
- [34]
- [33]
- [34]
-
- [33]

Outline of Defence Budget package options (not including ^[1,33]

[1,33]

[1,33]