

The Treasury

Budget 2017 Information Release

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[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
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[40]	Not in scope	

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.

Reference: T2016/1515

SH-1-6-3

Date: 12 August 2016

To: Minister of Finance (Hon Bill English)
Associate Minister of Finance (Hon Steven Joyce)
Associate Minister of Finance (Hon Paula Bennett)

Deadline: For your meeting on Monday, 15 August.

Aide Memoire: Terranova and Budget Allowances

Last week, Ministers asked for responses to questions raised by Treasury and SSC about costings and flow-on effects (T2016/1438 refers). You also asked how a settlement would affect the fiscal strategy. The following analysis uses costings from last week as we do not have updated numbers from the Ministry.

Costings and flow-ons

Treasury has had limited visibility of the evolution of the proposed settlement and the underlying costings. Last week, for the first time, we received and were able to review a summary costing model: this formed the basis of our comments about assumptions and flow-ons. We do not hold additional information. The Ministry of Health has prepared a short note on aged residential care, which we understand will be circulated via their Minister's office. This implies that the estimated fiscal costs to the Crown from aged residential care have increased. We have not seen revised costings, but at a rough guess, the impact might be an extra [38] per annum by year 5. The Ministry has not responded to the other points we raised last week.

The costing does not include private costs to people in aged residential care who have assets above the threshold (~\$220k). There are about 11,000 such people, who meet the costs of basic residential care themselves. The cost of basic care varies around the country, but on average we understand that it is about \$48,000 per year. If increased wage costs are passed on through higher prices (as we think likely), the proposed settlement will increase the cost of basic care by around [38] in year 1, and by around [38] by year 5, according to the Ministry's figures. These increases will be on top of (and compound) the usual annual price inflation.

Under current policy settings, these additional costs will be borne by individuals, so they are not counted towards the estimated fiscal cost. This is appropriate from a costing perspective, although increases in private costs may be controversial in practice. Based on the summary model we saw last week, the aggregate private cost is about [38] per annum (by year 5).

Budget allowances and OBEGAL

A settlement would most likely take effect from the start of the next fiscal year (2017/18). The average annual cost over the first four years [38] million per annum) would count against the allowance in Budget 17, which has been set at \$1.5 billion per annum. The increase in out-year costs ([38] million per annum) would impact on the forecast. This is summarised in figure 1. The gross cost of the settlement will hit the allowance, with no reason to expect an offsetting increase in economy-wide tax revenues.

Figure 1. Indicative pressures in Budget 17 and the fiscal impact of Terranova

[38]

It is still very early in the Budget process. Figure 1 provides a rough indication of known pressures at this stage, but these will change. Settling Terranova will make it difficult to manage initiatives within the Budget 2017 operating allowance and reduce any headroom available for discretionary spending. We will provide updated forecasts and advice on implications for the fiscal strategy in early November.

The impact on the surplus depends on the extent to which the costs of Terranova are in fact managed within the operating allowance. Table 1 illustrates a simple scenario in which other cost pressures and discretionary initiatives are assumed to fully absorb the allowance, with the gradually rising costs of Terranova thus affecting OBEGAL. This is just subtraction: we haven't considered wider effects of adjusting the fiscal strategy. In this scenario, net debt would be roughly [38] higher by 2020 compared to the Budget 2016 track: around [38] of GDP in 2020, compared to the Budget 2016 track of 20.8%.

Table 1. Terranova: OBEGAL impact if managed outside operating allowance (\$m)

	2017/18	2018/19	2019/20	2020/21	2021/22
OBEGAL (B16 forecast)	2,455	4,972	6,681	7,138*	8,313*
Terranova (fiscal cost)	[38]				
Adjusted OBEGAL					

* Projections per the fiscal strategy model

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