

17 February 2009

To: Katrina Bach, Belinda Clark, Geoff Dangerfield, Peter Hughes, Stephen McKernan, Iain Rennie, Brian Roche, Murray Sherwin, Maarten Wevers.

Copies to: Hon Bill English, Minister of Finance; Grant Johnston, Office of the Prime Minister; Chris White, Department of Prime Minister and Cabinet.

From: Treasury

Subject: Paper 2 on Savings and Emergency Pressures Submitted in Budget 2009

Introduction

This note provides the emergency pressures and savings submissions and the first cut of Treasury advice on those bids for your comment.

You received a paper last week which set out the Government's objectives for Budget 2009 and the submissions received from Ministers.

There have been some late bids and adjustments. The table below updates the overall picture, as of Tuesday 17 February.

Submissions received in 2009

	Operating					Capital	
	\$ million increase / (decrease)						
	2008/09	2009/10	2010/11	2011/12	2012/13	Total	Total
<i>Pressures</i>	56	618	641	713	617	2,645	337
<i>Savings</i>	(177)	(249)	(352)	(451)	(327)	(1,556)	(50)
Sub-Total	(121)	369	289	262	290	1,089	287
<i>Priorities</i>	(91)	1,112	1,410	1,541	1,598	5,570	1,422
<i>Technical</i>	4	10	10	12	14	50	1
Total	(208)	1,491	1,709	1,815	1,902	6,709	1,710

As you can see, emergency pressures exceed savings by \$1.089 billion operating over the forecast period (including 2008/09) and \$290 million in outyears. On the capital side, emergency pressures exceed savings by \$287 million.

Overall, operating and capital bids exceed the total funding available, especially given that some pre-Budget items such as the recent SME and infrastructure stimulus packages have already significantly reduced the Budget 2009 allowances available for spending.

- The *net* operating amount sought of \$6.709 billion over the forecast period (including 2008/09) exceeds the remaining operating allowance of around \$5.6 billion over the forecast period.

- The *net* capital amount sought totalling \$1.71 billion is more than twice the remaining capital allowance which totals \$760 million.

It should be noted that this aggregation of the overall situation does not imply any departure from the requirement for savings to pay for all emergency pressures.

Purpose of this paper

As the Minister set out with you in your meeting on Friday, the goal for this process is not just to match savings to pressures, although managing pressures will be important.

Given that the government wants to restore the fiscal position to a sustainable footing over the next 3 – 5 years, Budget 2009 is the first step in challenging the public sector to deliver more for less. In your meeting on Friday, the Minister stated his intention to:

- deliver the government’s policy priorities for its first year within the Budget 2009 allowances (and ideally at a level sufficiently *below* the Budget allowances to provide a credible demonstration of expenditure restraint); and to
- retain a residual amount of savings (after funding emergency pressures),

...in order to signal the government’s ongoing commitment to value for money expenditure.

This paper lists the savings and emergency pressures bids in detail, along with the first, preliminary cut of Treasury advice on these bids. The purpose of this paper is to elicit feedback on Treasury’s initial judgements and any other comments on what is within, or missing from, the submissions.

Initial Treasury assessment of emergency pressures and savings

Treasury has broadly categorised the emergency pressures and savings bids as as red/ amber/ green. The criteria used by Treasury to categorise bids are set out at the end of this document. In brief, red indicates Treasury does not support the bid, green indicates support and amber indicates that more work is required.

Firstly, we need to work through the amber bids to place them in either the red or green categories. The challenge is then to manage the emergency pressures which are in the green category, so that they do not require all the savings submitted. On the savings side, the challenge is to increase the savings in the green category.

Emergency pressures

Pressures	Departmental Submission					Total	Department Capital Total	
	Operating	2008/09	2009/10	2010/11	2011/12			2012/13
Red		25	144	165	208	222	763	301
Amber		7	312	303	310	298	1,230	82
Green		3	15	6	6	6	36	2
Total		35	471	473	524	527	2,029	385

Savings

Savings	Departmental Submission Operating					Total	Department Capital Total
	2008/09	2009/10	2010/11	2011/12	2012/13		
Red	(10)	0	0	(0)	(0)	(11)	1
Amber	(4)	(19)	(5)	(8)	(19)	(55)	(5)
Green	(142)	(174)	(269)	(344)	(307)	(1,237)	(46)
Total	(156)	(192)	(275)	(353)	(327)	(1,303)	(50)

Overarching themes

The following are some general, preliminary observations based upon the full set of bids and Treasury assessments:

Emergency pressures

- Some emergency pressures bids include significant remuneration components. The government has consistently signalled an expectation that the public service show active restraint on remuneration given current economic conditions. The SSC has also commented that many of the remuneration bids did not have appropriate supporting information.
 - Note: Some changes to industrial relations policy were discussed at Cabinet this week. Although the Treasury assessments in this paper were not able to be informed by any decisions taken at Cabinet, during the next week the effect of these changes on remuneration bids will be assessed and Treasury's recommendations (and possibly departmental submissions) updated as appropriate.
- Some emergency pressures bids do not adequately demonstrate that the department has examined which *other* areas of activity are lower value than the emergency pressure. There are also a number of areas where the Minister of Finance may look to reinforce his desire for Ministers and departments to think creatively and find innovative ways to deliver services more efficiently in the future.
- A number of submissions have noted that removing amounts of discretionary funding will make it tougher to reprioritise as future pressures arise. In effect, this suggests a transfer of risk, as well as funding, back to the centre. This underlines the need for ongoing balance between the responsibility of Ministers and CEs to manage pressures within their Votes, and the role of the centre in reallocating resources as priorities and pressures change across government.

Savings

- The savings figures are inflated by "savings" which are in a number of cases simply this year's or ongoing underspends which would have been returned to the Crown as a matter of course. Although underspends have not been excluded from the savings process, where underspends are not the result of a decision to spend less, then there will be no actual improvement in the fiscal position (although these may have the side effect of improving

forecast accuracy and so reducing the need for an annual top down adjustment in the aggregated forecasts).

- It is also apparent, and not unexpected, that Ministers have submitted savings bids with varying impacts. Most Ministers have largely created savings from non-core activities – or distinct programmes where the impact is minimised on their agency. On the other hand, a few Ministers have proposed noticeably deeper cuts to capability. For example, savings have been proposed that amount to 10% of personnel for one small agency. While there is no absolute benchmark for what degree of savings is appropriate from individual agencies (given the difficulty in assessing starting positions) it is important to note that there are mechanisms to ensure any reallocation of resources reflects Ministerial priorities rather than only which bids have been submitted:
 - All Budget decisions are made by Ministers, generally in the Budget bilateral meeting. The bilaterals process is informed by a Budget Ministers assessment of the aggregate picture. Treasury is likely to include advice on additional areas of savings for the Budget Ministers meeting (see below).
 - Where a Minister’s bids would result in relatively little savings from the agency, or conversely would heavily impact on the agency’s service delivery, there is the ability to use the longer-term VfM process to judge appropriate levels of activity over time.
 - The Minister of Finance has made clear that he wants to create a structure of incentives that encourages Ministers and their CEs to contribute to the government objectives in this area and that alternative mechanisms will be explored where this is not the case.

As a general comment, this exercise appears to be more effective in considering the funding of discrete policies and programmes. It is less effective for revealing and making decisions on core government services. For these latter areas of government spending, it is anticipated that the longer term VfM approach, (perhaps better expressed as a *price x quantity* decision), will be more effective.

Further savings options

There are also some potential areas of savings which have **not** been submitted by Ministers but which Treasury believes warrant further consideration. Subject to further assessment, our intention is that these would be discussed in the bilateral alongside submitted savings bids.

Areas that could be looked into for further, immediate savings include:

- a A number of departments have received substantial funding increases in recent years (over 100% in some cases). These could be looked at closely to identify any savings that could be generated without affecting the delivery of critical services.
- b Savings do not appear to have been specifically identified in the areas of communications/PR staff and policy staff, these and other similar “back-room” functions could be looked at more explicitly by most departments, particularly where these functions have expanded rapidly in recent years.
- c In general, most savings appear to have been generated out of the Crown side of votes as opposed to the departmental. Much closer attention should be paid to identifying enduring savings from departmental appropriations.

We are seeking your feedback on our judgements in these areas. We are also interested in views on *any other areas of government expenditure where you would suggest savings are appropriate in Budget 2009.*

Attached material

As noted above, please find attached complete tables of both the emergency pressures and savings bids (in A3 pages). Also attached are a set of one page Treasury assessments of each department’s savings and emergency pressures bids. You have already received a hard copy of the emergency pressures and savings bids submitted by the departments (as one page CFISnet entries rather than the full word documents).

The bids in the A3 tables have been broadly categorised as red/ amber/ green as a means of clearly presenting the current status of bids in Treasury’s preliminary advice. The broad criteria used by Treasury to categorise bids as red/ amber/ green are set out below:

	Savings	Pressures
Red	<ul style="list-style-type: none"> Proposed savings are likely to increase costs elsewhere and / or would result in an unacceptable service failure to the public. 	<ul style="list-style-type: none"> Not funding will not result in unacceptable service failure to the public.
Amber	<ul style="list-style-type: none"> Insufficient information provided to determine whether proposed savings are likely to increase costs elsewhere and / or would result in an unacceptable service failure to the public Treasury considers that further savings can be made from within the Vote. 	<ul style="list-style-type: none"> Insufficient information provided to determine whether the emergency pressure is likely to increase costs elsewhere and / or would result in an unacceptable service failure to the public
Green	<ul style="list-style-type: none"> Proposed savings will not increase costs elsewhere and / or will not result in an unacceptable service failure to the public. 	<ul style="list-style-type: none"> Additional funding is necessary to avoid an unacceptable service failure to the public.

Notes:

As noted in the previous paper, the purpose of the senior executives group is to test Treasury’s judgements and advice. If at the end of this process there is a difference in opinion between the senior executives’ group and the Treasury, this will be reflected in Treasury’s advice to Budget Ministers.

Longer term issues around value for money will be dealt with in parallel through the Expenditure Control Committee line by line review process.

Because this is not yet a final Treasury assessment there may be some specific instances of inconsistency between the one pagers for each department and the categorisation of bids as red/amber/green. Treasury will address this over the next week.

As noted above, Cabinet considered options for changes to the industrial relations regime in the public sector this week. The Treasury assessments in this paper were not informed by the decisions on this matter. During the next week the effect of these changes on remuneration related bids will be assessed and Treasury's recommendations updated as appropriate.

Vote Health is not included in the central process for prioritisation of savings and emergency pressures in Budget 2009 but is included in the lists attached to this report for the sake of completeness and accuracy. The set of one page Treasury assessments includes one for Health but we understand the Director General of Health will also bring a separate report to the Group for consideration.