

Treasury Report: Budget 2009: Bilateral for Votes Defence, Defence Force and Research, Science and Technology

Date:	6 March 2009	Report No:	T2009/483
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Read the attached briefing and use it as the basis for taking decisions in your bilateral with Hon Dr Mapp at 10:30 a.m. on 12 March 2009.	12 March 2009
Associate Minister of Finance (Hon Simon Power)	Read the attached briefing and use it as the basis for taking decisions in your bilateral with Hon Dr Mapp at 10:30 a.m. on 12 March 2009.	12 March 2009

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Malcolm McKee	Manager, Justice and Asset Management	<i>Deleted-privacy</i>	<i>Deleted-privacy</i>	✓
<i>Deleted-privacy</i>	Senior Analyst, Justice and Asset Management	<i>Deleted-privacy</i>		
<i>Deleted-privacy</i>	Analyst, Productivity and Innovation	<i>Deleted-privacy</i>		

Minister of Finance's Office Actions (if required)

None.

Enclosure: Yes

Treasury Report: Bilateral Briefing for Votes Defence, Defence Force and Research, Science and Technology

This report contains a briefing for the bilateral between the Minister of Finance and the Hon Dr Mapp at 10:30 a.m. on 12 March 2009 to discuss the Budget initiatives for Votes Defence, Defence Force and Research, Science and Technology.

The bilateral briefing covers three votes:

Vote Defence	p. 3
Vote Defence Force	p. 6
Vote Research, Science and Technology	p. 9
Annex RS&T budget bid analysis	p 15

We expect the key issues for discussion will be:

- the **Defence Funding Package – Year 5** increment. Treasury's view is the Defence Funding Package should be required to absorb all identified cost pressures for Votes Defence Force and Defence.
- the **Defence Review 2009** on options to ensure long term alignment and sustainability of Defence policy, capability and funding. This will be the main avenue for achieving value for money in the Defence votes, e.g. improving capital asset management. A White paper is expected in 2009 that would feed into future budgets.
- the level of new funding to be committed for **RS&T initiatives signaled in pre-election announcements** and the level of savings offered by the department. Treasury's view is a higher level of savings can be found and that no new funding should be supported. However, if funding is to be agreed, we suggest you agree an envelope of funding with the Minister of RS&T of no more than 1/3 of the savings from the repeal of the R&D tax credit.

Vote	Department	Likely to attend
Defence	Ministry of Defence	John McKinnon, Secretary of Defence <i>Deleted-privacy</i>
Defence Force	NZ Defence Force	Lt Gen Jerry Mateparae, Chief of Defence Force <i>Deleted-privacy</i>
RS&T	MORST	Helen Anderson, Chief Executive Roger Ridley, General Manager

Recommended Action

We recommend that you **read** the attached briefing and use it as the basis for taking decisions in your bilateral with Hon Dr Mapp at 10:30 a.m. on 12 March 2009.

Malcolm McKee
Manager Justice and Asset Management

Hon Bill English
Minister of Finance

Overview of the Vote

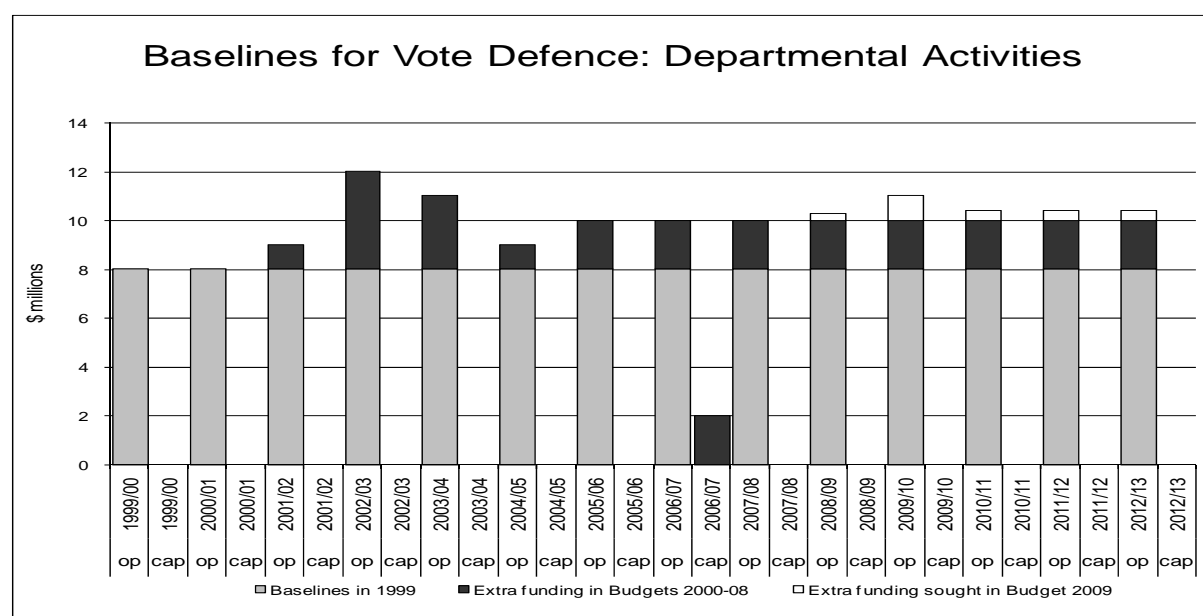
VOTE DEFENCE (MINISTRY OF DEFENCE)

- As part of the Minister of Finance's request to Vote Ministers to carry out a line-by-line review, submission of emergency pressures and policy priorities, the Minister for Vote Defence submitted the following:

	\$million - increase/(decrease)					
	2008/09	2009/10	2010/11	2011/12	2012/13 & Outyears	Treasury Recommendation
<i>Operating (GST excl)</i>						
Savings	-	-	-	-	-	
Emergency pressures	-	0.400	0.400	0.400	0.400	Partially Fund
Policy priorities	0.290	0.710	-	-	-	Support
Total funding requested	0.290	1.110	0.400	0.400	0.400	
<i>Capital (GST excl)</i>						
Total funding requested	-	-	-	-	-	

Analysis of Vote and Savings Proposals

- Treasury's view on the savings submitted by the Vote is that they are **not adequate**. Despite the relative low departmental output expenses and the limited growth over time, we assess that savings are achievable in corporate overheads and could be used to partially offset the emergency pressures presented. We have been cognisant of this in developing our advice on the emergency pressure initiative. Alternatively, if the emergency pressure is not agreed, savings of \$200,000 p/a could be expected from the Vote.
- Vote Defence baselines are shown in the graph following. The Vote has received minimal increases in funding in the past 8 years.



Emergency Pressure

4. The Minister has submitted an emergency pressure bid to mitigate the fiscal risk associated with upcoming Defence equipment projects via the engagement of two additional acquisition project managers.
5. Treasury considers that this represents good value for money because it has potential to reduce acquisition delays described in the recent OAG review of Defence acquisition projects and the risk of poor project outcomes. Investing in high quality acquisitions staff reduces the risk of considerable additional project related costs being incurred subsequently. This initiative can be scaled by \$200,000 yet still deliver the impact desired with the additional funding for this initiative being found within existing baselines.

Recommendations

Treasury recommends that you:

- (i) **Support** the emergency pressure submitted for Vote Defence at the reduced amount of \$200,000 p/a from 2009/10, offset by a reduction in the Defence Funding Package – Year 5 pre-commitment in 2009/10.

Agree/Disagree

- (ii) If you do not support the emergency pressure bid in (i) above, **support** taking savings from Vote Defence at the level of \$200,000 p/a.

Agree/Disagree

Value for Money/Strategic Direction

6. The 2009 Defence Review includes an opportunity to examine and advise Ministers on options for improving value for money and sustainability within the Defence votes, affecting both the Ministry of Defence and the New Zealand Defence Force.
7. The Review will affect Votes Defence and Defence Force in Budgets 2010/11 and 2011/12 and beyond. We suggest the following points for discussion:
 - o Hon Dr Mapp is currently finalising the **Terms of Reference** for Cabinet consideration. This covers scope, governance arrangements and key milestones. Difficult trade-offs are likely to emerge from the Review. What does Hon Dr Mapp seek to achieve with the Review? Is he intending to engage with you and other Ministers?
 - o Consider stating your expectation is that the review will provide a range of **fiscal scenarios**. To ensure credible options for Ministers, you could raise explicit expectations that the advice covers different fiscal scenarios, including below current baseline scenarios. Is Hon Dr Mapp considering a range of fiscal scenarios?
 - o Defence agencies are **forecasting** about a **\$3 billion capital shortfall** over the next ten years (25% of your capital allowance over this period). Does Hon Dr Mapp see the Defence Review being able to manage back these capital pressures?
 - o What are the main **organisational** issues and **value for money** opportunities that the Review will address? Will the Review explore the relationship between the Ministry of Defence and the New Zealand Defence Force to determine whether the arrangement put in place by the 1990 Defence Act are optimal and meeting the Government's needs?

Vote Defence – Analysis of Policy Priorities

8. Vote Defence has submitted the following policy priority initiative:

a Conduct of the 2009 Defence Review

	<i>\$million - increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	0.290	0.710	-	-	-
Treasury	0.290	0.710	-	-	-

9. The department seeks funding in order to conduct the 2009 Defence Review. This is a one-off expense that is not currently funded within Vote Defence baselines.
10. Treasury considers that this is value for money expenditure as a Defence Review is clearly required and consistent with the Government's priorities. The Vote Defence baseline does not contain provision for large one-off activities such as conducting a Defence Review. The costing of the review has been developed at short notice without the Terms of Reference for the review having been finalised or a project plan developed. However, using the recent Australian Defence Review as a comparator, Treasury considers \$1 million to be reasonable. The initiative includes costs for external advice on procurement and external costing of force structure options to provide Ministers with greater confidence.
11. This initiative can be scaled further if components of the review such as public consultation (\$250,000) or the expert panel (\$200,000) were to be removed from the scope of the review.

Recommendations

Treasury recommends that you:

- (iii) **Support** funding for the 2009 Defence Review at the proposed amount totalling \$1 million, offset by reduction in the Defence Funding Package – Year 5 pre-commitment in 2009/10.

Agree/Disagree

Overview of the Vote

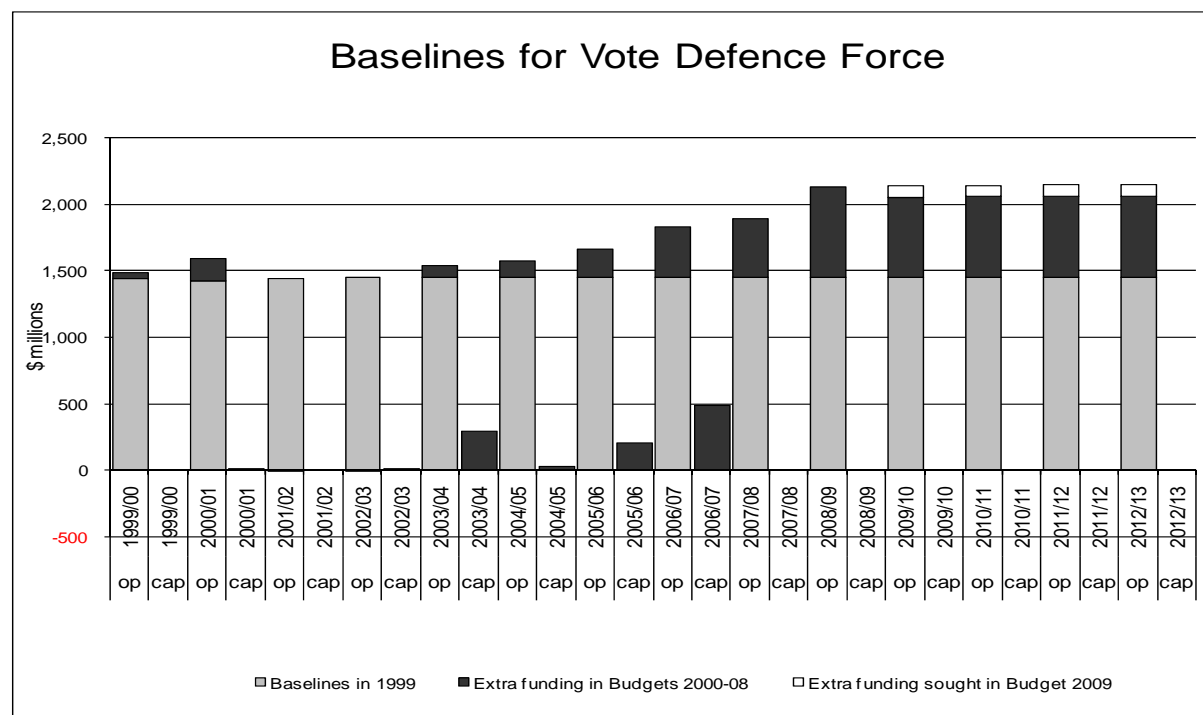
VOTE DEFENCE FORCE (NEW ZEALAND DEFENCE FORCE)

12. As part of the Minister of Finance's request to Vote Ministers to carry out a line-by-line review, submission of emergency pressures and policy priorities, the Minister for Vote Defence Force submitted the following:

	\$million - increase/(decrease)					
	2008/09	2009/10	2010/11	2011/12	2012/13 & Outyears	Treasury Recommendation
<i>Operating (GST excl)</i>						
Savings	(40.000)	-	-	-	-	Support
Emergency pressures	-	-	-	-	-	
Policy priorities	-	85.718	85.718	85.718	85.718	Partially Fund
Total funding requested	(40.000)	85.718	85.718	85.718	85.718	
<i>Capital (GST excl)</i>						
Total funding requested	-	-	-	-	-	

Analysis of Vote and Savings Proposals

13. Treasury's view is the savings submitted by the Vote are **adequate**.
14. Vote Defence Force baselines are shown in the graph below. The Vote has received significant increases in funding in the past four years due to Cabinet approval of the 10 year Defence Funding Package (DFP). However the DFP has not allowed the Defence Force to grow at the rate agreed given in part the higher than predicted impact of recent overseas deployments and the impact that depreciation costs from recent acquisitions have had in reducing what DFP funding is available for personnel growth and a range of other measures that were to be delivered as part of the DFP.



Recommendations

Treasury recommends that you:

- (iv) **Support** the \$40 million savings submitted for Vote Defence Force.

Agree/Disagree

- (v) **Agree** Vote Defence Force should be considered for further savings review as part of the 2009 Defence Review.

Agree/Disagree

Emergency Pressure

15. The Minister has submitted then withdrawn an emergency pressure bid for costs associated with Operational Deployed Forces. It will instead be raised in a separate Cabinet Paper. This is because leaving the decision until the Budget 2009 Cabinet Paper will almost certainly see Vote Defence Force unappropriated against the Operational Deployed Forces output class. In reaching our recommended position on the Defence Funding Package – Year 5 bid, we have deducted the 2009/10 \$32 million cost of this emergency pressure.

Value for Money/Strategic Direction

16. The next steps in Value for Money for Vote Defence Force are intimately tied into the 2009 Defence Review. This has been largely covered under Vote Defence however there is a sense across central agencies that NZDF is trying to do too much all at one time.
17. The high overseas deployment tempo along with implementing the DFP and introducing a large number of new platforms (Helicopters, Aircraft, Ships, Armoured Vehicles) has created significant pressure points. A Defence Review will add to the challenges NZDF is currently facing and will require careful management to ensure significant failures do not manifest.
18. We also see a potential fiscal risk for Budget 2010 if the Review is not complete and Vote Defence Force is seeking further funding to maintain status quo service delivery levels until the Defence Review is complete. You may want to discuss with Hon Dr Mapp the likelihood that the Review can be completed in time for Cabinet to take decisions that will inform Budget 2010.
19. The main issues that will affect Vote Defence Force in Budgets 2010/11 and 2011/12 will be implementing the decisions taken following the Defence Review while at the same time continuing to introduce and integrate a number of new capital assets and meet the operational deployments the Government has agreed.

Vote Defence Force – Analysis of Policy Priorities

20. Vote Defence Force has submitted the following policy priority initiative:

b Defence Funding Package – Year 5

	<i>\$million - increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	85.718	85.718	85.718	85.718
Treasury	-	52.000	85.718	85.718	85.718

21. The department seeks the Budget 2009 element of an earlier Budget 2005 agreement to restore military and organisational capability through new funding as a charge against future budgets.
22. Treasury considers that this initiative should be supported at a scaled level such that the other Defence agencies cost pressures identified in 2009/10 (Operational Deployed Forces and the Defence Review) are offset against this pre-commitment.
23. Our assessment recognises the DFP is more than a pre-commitment. The DFP includes in part the operating cost impact of previous capital projects agreed by Cabinet. Restricting DFP funding may result in NZDF not being able to operate new equipment about to be delivered by the Ministry of Defence. Treasury does not support the continuation of separate capital and operating funding envelopes for Vote Defence Force and would recommend in the future that operating costs are appropriated at the same time fixed asset purchasing decisions are taken.
24. We have also presented a scaled option at \$52 million and a no funding option. If you have an expectation that the Defence Review definitely needs to deliver net savings from Vote Defence Force baselines, you may wish reduce out-year funding as a means of signalling to NZDF the need to start adjusting for future reductions.

Recommendations

(vi) **Please circle the preferred option (Minister of Finance):**

Department preferred option	Treasury preferred option	Scaled option	No funding
\$85.718 million over the period	\$52 million in 2009/10 and \$85.718 million over the period	\$52 million over the period	

Overview of the Vote

VOTE RESEARCH, SCIENCE AND TECHNOLOGY (RS&T)

25. As part of the Minister of Finance's request to Vote Ministers to carry out a line-by-line review, submission of emergency pressures and policy priorities, the Minister of RS&T submitted the following:

	<i>\$million - increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Operating (GST excl)</i>					
Savings	-	(0.180)	(0.250)	(0.250)	(0.250)
Emergency pressures	-	-	-	-	-
Policy priorities*	-	97.989	128.660	157.120	157.120
Total funding requested	-	97.809	128.410	156.870	156.870
<i>Capital (GST excl)</i>					
Savings	-	-	-	-	-
Emergency pressures	-	-	-	-	-
Policy priorities	-	4.300	30.000	1.000	-
Total funding requested	-	4.300	30.000	1.000	-

* Includes bid for Vote Education initiative (Performance Based Research Fund).

26. Note that the unwinding of the unfunded ET pre-commitment of the previous Government means that Vote RS&T will have the following additional baseline reduction, relative to the increases announced at Budget 2008:

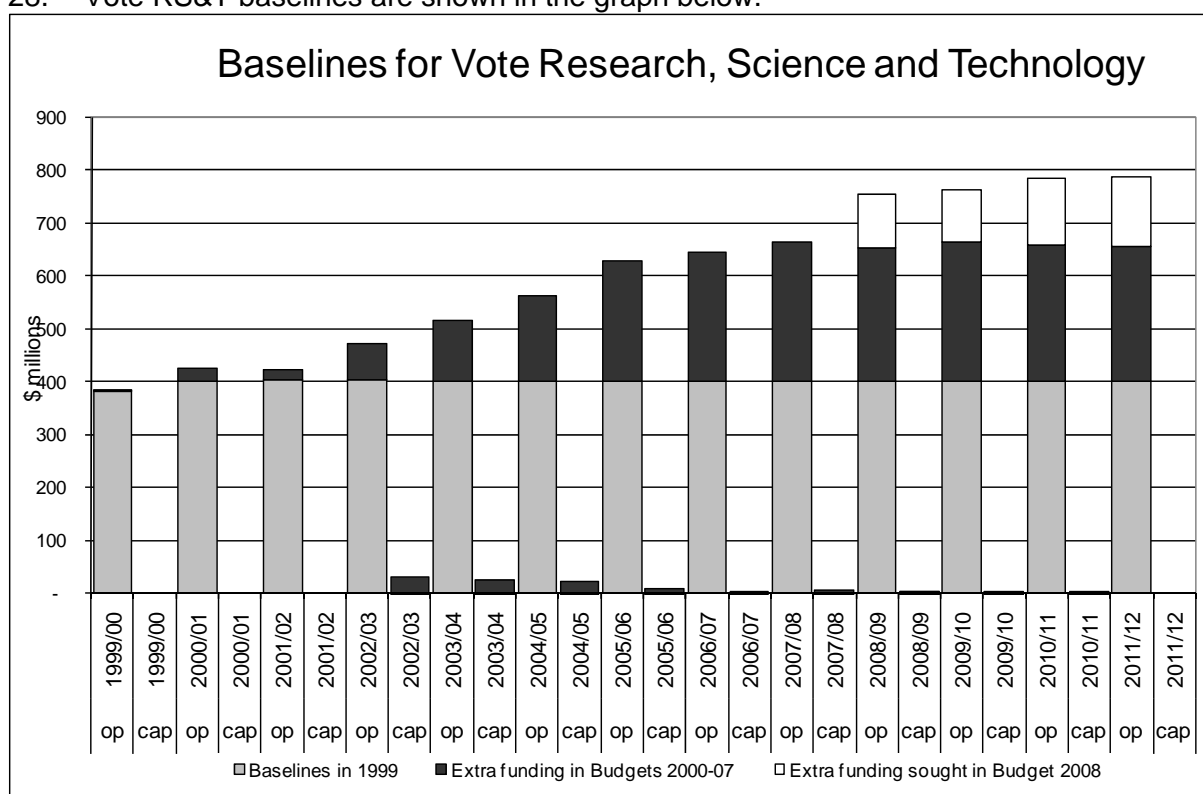
	<i>\$million - increase/(decrease)</i>				
<i>Operating (GST excl)</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
Unwinding ET: Innovation pre-commitments in Vote RS&T	-	(37.366)	(20.748)	(31.168)	(30.918)

27. Also note that the Government's pre-election announcements included using 1/3 of the savings from repealing the R&D tax credit for RS&T initiatives. The savings are quantified below, noting a small variance between the DEFU forecast for the savings and the assumptions used in the manifesto (based on previous forecasts). The variance is not material in terms of the overall fiscal position.

	\$million - increase/(decrease)				
<i>Operating (GST excl)</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
1/3 R&D tax credit savings					
<i>Based on DEFU forecast</i>	<i>(18.000)</i>	<i>(81.000)</i>	<i>(97.000)</i>	<i>(111.000)</i>	<i>(124.000)</i>
<i>Manifesto costing</i>	-	<i>(90.000)</i>	<i>(110.000)</i>	<i>(120.000)</i>	<i>(120.000)</i>

Analysis of Vote

28. Vote RS&T baselines are shown in the graph below.



NB: Baselines have been adjusted to reflect the unwinding of unfunded Budget 2008 ET commitments and proposed expense transfers in the 2008/09 March Baseline Update.

29. Both departmental and non-departmental expenditure has grown in recent years. The vast majority of the funding is for research outputs and the administrative burden still represents a small fraction of the total Vote. MoRST's operating budget is \$14 million or 2% of the Vote, while research contract management (by FRST and other agents) costs \$21 million or 3% of the Vote.
30. There has been relatively significant growth in the baselines over the last ten years. Nominal growth in the departmental baseline has increased 176% over the period 1998-2008. The non-departmental baseline has grown by 75% over that period. A driver of the growth in departmental funding has been the greater role for MoRST in providing advice on innovation policy, sector-wide strategy-setting and on advising on science system reforms which have changed the system from a purely contestable system to a hybrid model combining multiple research funding mechanisms.

Savings

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

31. We understand the Minister of RS&T is working on savings options with his Ministry.

Recommendations

Treasury recommends that you:

- (vii) **Agree** the savings submitted for Vote RS&T relating to the cancellation of the evaluation of the R&D tax credit.

Agree/Disagree

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

Agree/Disagree

- (viii) **Indicate** whether you wish to seek additional savings for Budget 2009 based on the lowest value expenditure identified in the line-by-line review of Vote RS&T:

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

Yes/No

OR:

Direct MoRST to report back to the Ministers of RS&T and Finance by 20 March 2009 with further savings options

Yes/No

Emergency Pressures

32. The Minister of RS&T has submitted no emergency pressure bids.

Value for Money/Strategic Direction

33. The Minister of RS&T has an agenda which encompasses issues with value-for-money dimensions around ensuring the funding system minimises complexity and transaction costs for research organisations.

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

34. However, there is a risk that these initiatives don't add up to a set of actions which make a significant difference to innovation performance, and therefore the long-run growth potential of the economy. We have briefed you on specific options to support firms' innovation [T2009/436]. Consistent with that advice, Treasury sees the most important value-for-money issues for the public research system as being around:

- **The end-user: getting optimal uptake and application of R&D.** Ensuring the RS&T system provides the right incentives to get optimal uptake and application of knowledge to end-users, noting that New Zealand performs relatively well on measures of basic research outputs but poorer on measures of knowledge application and commercialisation; and
- **The producer: shifting the balance of R&D produced toward the private-sector.** The weight of evidence points toward private sector R&D as being critically important to productivity. New Zealand has a high proportion of its R&D performed in the public sector, so we would recommend policy changes that both aim to stimulate business R&D and ensure our public research organisations have strong links to business.
- **The government: reducing fragmentation of interventions.** There is a problem with the effectiveness and coherence of government's innovation interventions due to a proliferation of programmes, policies and agencies.

35. We propose progressing these issues as we engage with you over the coming year, and MoRST applying itself to follow-up on its line-by-line review in preparation for Budget 2010.

Recommendations

Treasury recommends that you:

- (ix) **Note** that we consider there are policy actions available to government to improve the RS&T system's contribution to economic performance.

Vote Research, Science and Technology – Analysis of Policy Priorities

36. Treasury's best advice is to commit no further funding toward Vote RS&T at Budget 2009 and focus on raising the quality of existing expenditure by focussing on the areas of weakness in the New Zealand innovation system – which we would see as being in the areas of private sector R&D, commercialisation and getting better uptake of public R&D by end-users.
37. However, if you wish to proceed with the pre-election policy of using savings from 1/3 of the R&D tax credit to fund RS&T initiatives, we have some alternative approaches which may be more useful than negotiating over each initiative with the Minister of RS&T.
38. We suggest you select one of the following approaches for the bilateral with the Minister of RS&T (in order of Treasury preference):

Overall approach to RS&T bilateral	Implications
Option 1: No increased funding (Treasury preferred)	Reprioritisation. Need to consider what reprioritisation choices should be made (e.g., whether to fund KAREN). Process. Suggest you invite the Minister of RS&T to submit by letter any reprioritisation proposals by 20 March.
Option 2: Request that the Minister of RS&T designs a scaled package of initiatives which: <ul style="list-style-type: none"> a) costs no more than the savings from 1/3 of the R&D tax credit; and b) incorporates initiatives which are better aligned with firm innovation and broader productivity objectives. 	Fiscal cost. To make the package have no impact on the operating allowance we suggest agreeing that the package cost no more than the savings from 1/3 R&D tax credit. Choose a funding profile: <i>Manifesto costing across all years:</i> 2009/10: \$90m 2010/11: \$105m 2011/12: \$120m <i>Manifesto costing in first year only:</i> 2009/10: \$90m 2010/11: \$90m 2011/12: \$90m The latter allows you to retain some flexibility going into Budget 2010. Package make-up. Request advice from MoRST and Treasury by March 20 on alternative package.
Option 3: Request that the Minister of RS&T designs a scaled package of initiatives which: <ul style="list-style-type: none"> a) costs no more than the savings from 1/3 of the R&D tax credit; and b) incorporates scaled versions of the bids already submitted. 	Fiscal cost. As above for Option 2. Package make-up. Request Minister of RS&T submit a re-scaled package by letter by 20 March. Advice on implementation. Request advice from relevant agencies on improving effectiveness of initiatives, as set out in Treasury recommendations on the following pages.
Option 4: Negotiate over each initiative in turn during the bilateral.	Make choices about the bids as set out in the accompanying annex.

ANNEX A RS&T BUDGET BID ANALYSIS

a Savings from R&D tax credit - Performance Based Research Fund, Marsden Fund and Health Research

	<i>\$million – increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
Operating (GST excl)					
<i>PBRF (Vote Education)</i>		<i>15.000</i>	<i>17.500</i>	<i>20.000</i>	<i>20.000</i>
<i>Marsden Fund</i>	-	<i>15.000</i>	<i>15.000</i>	<i>15.000</i>	<i>15.000</i>
<i>Health Research</i>	-	<i>15.000</i>	<i>20.000</i>	<i>25.000</i>	<i>25.000</i>
Department	-	45.000	52.500	60.000	60.000
Treasury	-	-	-	-	-

1. The department seeks funding for three research funds, consistent with the Government's pre-election announcements.
2. All three existing funds purchase quality public-good research outputs, but Treasury does not support additional funding as we consider that these areas of expenditure are low priority if the objective is promoting productivity growth.
3. Various indicators show that scientific performance in New Zealand is already strong and New Zealand spends about 0.4% of GDP on basic research which is the OECD average. New Zealand is in the top-third of OECD countries in terms of quantity of the production of scientific articles per capita.
4. Specific comments are below:

Fund	08/09 baseline (\$m)	Increase proposed (%)	Treasury comment
PBRF	236.114	8.5%	The PBRF promotes competition and quality in tertiary research. However, we are concerned that it over-incentivises citation in international journals and under-incentivises research impact and relevance to NZ.
Marsden	37.878	39.6%	Supports high prestige basic research with no social or economic objective. Some value if research leads to long-term, high-payoff breakthroughs or increases the attractiveness of NZ to top international researchers. The proposed increase is substantial.
Health	62.955	39.7%	Contestable health research outputs. Potentially high value if can link well into health delivery as asserted in budget bid, but there is limited assurance around this. The increase is substantial relative to existing funding levels.

Recommendations

Please circle the preferred option (Minister of Finance):

Department preferred option	Treasury preferred option	Scaled option
\$217.500 million over four years	No funding	Scale to fit within RS&T package that costs no more than offsetting savings from 1/3 of the R&D tax credit (manifesto costing).

If you support funding at some level, Treasury recommends that you:

- (i) **Agree** that officials from innovation agencies should look at the issue of whether the PBRF's incentives on researchers could be tweaked to best reward research impact and relevance, and report back to Ministers in due course.
Agree/Disagree
- (ii) **Direct** MoRST, in consultation with the Treasury and MoH, to report back by 1 June 2009 to the Ministers of RS&T and Health on the specific actions and measurable performance targets to be agreed with the Health Research Council to get research outputs which promote innovation in health delivery.
Agree/Disagree

b CRI Capability Fund

	<i>\$million – increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	30.000	45.000	60.000	60.000
Treasury	-	-	-	-	-

- The department seeks funding consistent with the pre-election commitment for a secure funding allocation for CRIs. The current size of the Fund is \$50 million per annum, so the bid for \$60 million represents a 120% increase.
- The CRI Capability Fund is a direct grant to CRIs without any expectation of outputs (in contrast to FRST research funding which contracts CRIs for specific research outputs, through contestable or negotiated processes). The purpose of the CRI Capability Fund is to devolve some funding decisions to CRIs so that they can allocate funding to research projects which are not funded by other sources. The expectation is that it should support projects which are emerging opportunities or 'between funding sources', to limit disruption to research capability from the funding decisions made by FRST and other purchase agents.
- Some commentators consider that the CRIs face too much competition in their funding. The 2007 Review of New Zealand's Innovation Policy by the OECD also made a recommendation to increase core funding for CRIs. Treasury considers that much of this analysis is outdated and does not take account of the significant moves away from contestability over the last five years. As well increasing the size of the CRI Capability Fund, FRST contracts are now four years on average, and some are up to 8-12 years. In addition, 30-40% of major research funds administered by FRST are 'negotiated', not contestable, meaning a number of CRI research programmes do not have to go through competitive processes to re-apply for funding.

8. We see risks in these moves away from competition, in terms of reducing science quality and the responsiveness of the funding system to new research needs or new talent. We would not support further moves toward stable funding until there is evidence that current moves have led to better outcomes.

Recommendations

Please circle the preferred option (Minister of Finance):

Department preferred option	Treasury preferred option	Scaled option
\$195.000 million over four years	No funding	Scale to fit within RS&T package that costs no more than offsetting savings from 1/3 of the R&D tax credit (manifesto costing).

If you support funding at some level, Treasury recommends that you:

- (iii) **Direct** MoRST and the Treasury to report back to the Ministers of RS&T and Finance by 1 June 2009 on options to modify the CRI Capability Fund allocation formula to ensure the CRI Capability Fund puts good incentives on CRIs.

Agree/Disagree

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

c Prime Minister's Prizes for Science

	<i>\$million – increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	1.280	1.280	1.280	1.280
Treasury	-	-	-	-	-

9. The department seeks \$1.280 million per annum to establish new prizes to increase the prestige of science. \$1 million would be used for prizes; \$280,000 would be spent on administration and an awards event.
10. Treasury considers this to be a low value initiative.
11. Treasury would suggest Ministers consider reprioritising existing expenditure which is aimed at supporting talent and/or raising the profile of science. Current expenditure includes:

Appropriation	Current baseline (\$m)	Description
Engaging New Zealanders with Science and Technology	6.071	Activities that develop New Zealanders' awareness of the importance and value of science and technology to themselves and to New Zealand.
Supporting Promising Individuals	18.907	Scholarships and fellowships supporting research career development.
Rutherford Foundation	1.000	A grant to the Royal Society of New Zealand for the newly established Rutherford Foundation. The foundation gives awards to support the development of early and mid career scientists.

Recommendations

Please circle the preferred option (Minister of Finance):

Department preferred option	Treasury preferred option	Scaled option
\$5.120 million over four years	No funding	Scale to fit within RS&T package that costs no more than offsetting savings from 1/3 of the R&D tax credit (manifesto costing).

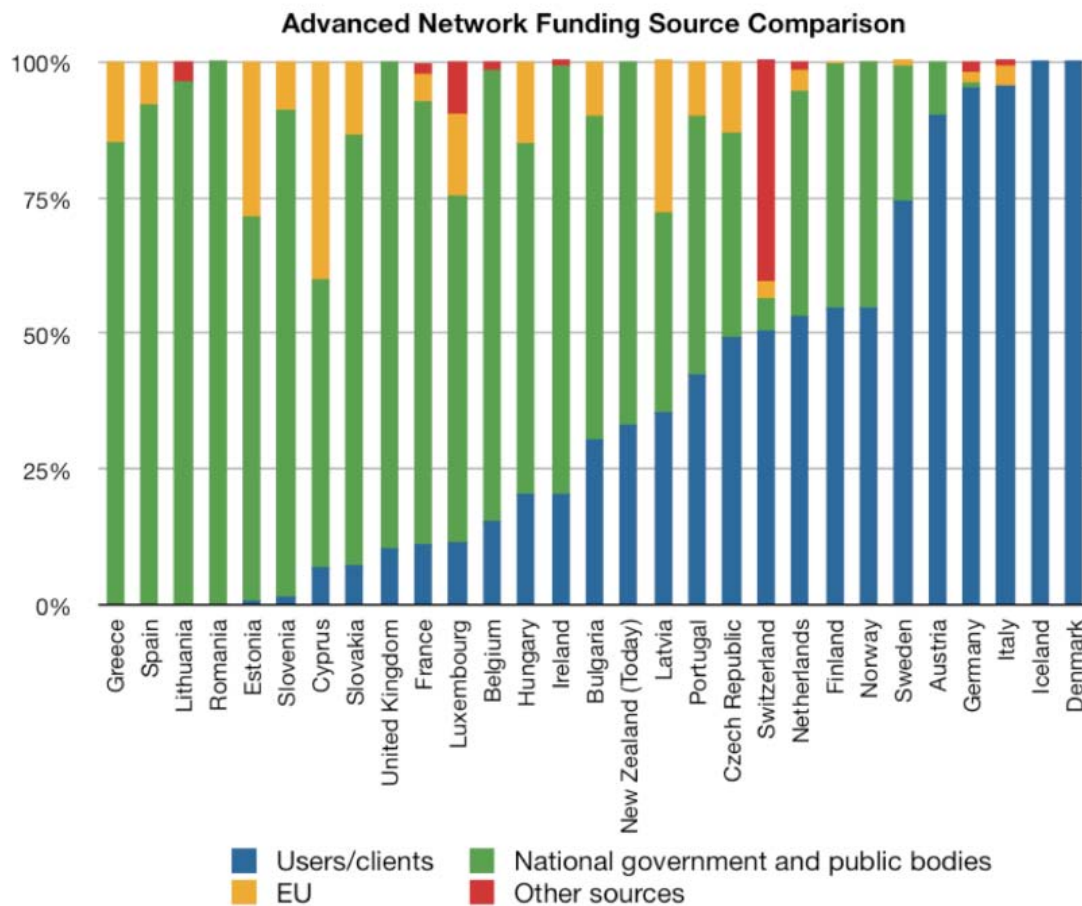
d Kiwi Advanced Research and Education Network (KAREN)

	<i>\$million – increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Capital (GST excl)</i>					
Department	-	-	28.000	-	-
Treasury	-	-	-	-	-

12. The department seeks a \$28 million capital injection for the Research and Education Advanced Network of New Zealand Ltd (REANNZ), a Crown-owned company which operates the KAREN high-speed broadband network for research and education institutions (universities, CRIs, National Library, some schools and polytechnics).
13. The capital would support KAREN until 2015 at which point there would be more funding needed. The consequence of not funding would mean KAREN would cease to exist. However, research institutions would still be able to purchase networking services from the private sector, so we do not see this as a fundamental service delivery risk.
14. REANNZ is a procurement vehicle. It buys network services from the private sector, and delivers them to users (CRIs and universities). Current contracts are expiring at the end of 2009, and if the government does not choose to commit to further Crown funding, REANNZ would be projecting insolvency by 2011 and therefore the Board would act to wind up the company this year.
15. The most obvious explanation of the funding shortfall is that users appear to value the service less than it costs to run the service. There is an argument that REANNZ represents a form of large-scale, infrastructure for which it is difficult for CRIs and universities to see the value in the short-term. By 2015 we would expect users to see that value and therefore we propose that REANNZ is expected to become financially self-sustaining post-2015.
16. *[Information deleted –free and frank advice of officials]* and would prefer that users, rather than the Crown, make choices about their networking needs. **However, on balance, we think it is worth government persevering with KAREN to keep up with the rest of the world and support the collaborative R&D programmes which have high economic potential and rely on this infrastructure.**
17. Therefore we propose that the initiative is funded from within the funding envelope agreed for RS&T and/or reprioritisation. Since the primary beneficiaries are research and education users it would seem reasonable to re-direct funding within Vote RS&T and/or Vote Education. Alternatively, the one-off cost could be met from scaling back funding for the initial years of other supported RS&T budget bids.
18. The cost of \$28 million is what the Board of REANNZ believe is necessary to keep REANNZ viable. We cannot give definitive assurance that this is the lowest possible amount; there is much uncertainty about the willingness to pay of users (particularly when confronted with the real, not theoretical, prospect to KAREN ceasing) and the actual level of investment needed to meet the needs of New Zealand's research and education institutions.

[Information deleted –commercially sensitive]

19. Note that the \$28 million costing already assumes [Information withheld – commercially sensitive]



Source: REANNZ, *REANNZ Today*, June 2008

Recommendations

[Information deleted –commercially sensitive]

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

e Foundation for RS&T - Project Phoenix Phase 2

	<i>\$million – increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	(1.000)	-	-	-	-
Treasury	(1.000)	-	-	-	-
<i>Capital (GST excl)</i>					
Department	-	1.300	-	-	-
Treasury	-	1.000	-	-	-

20. The department seeks funding on behalf of FRST to complete the IT system it has been building to manage its research contracts (Project Phoenix). The project has had a number of problems and cost overruns. However we are assured by MoRST

that this funding will ensure it is completed and will have benefits in terms of the efficiency and simplification of funding processes.

21. Treasury is therefore comfortable with the operating-to-capital swap (operating saving is from FRST) but on a fiscally neutral basis, rather than a \$300,000 net increase in funding.

Recommendations

Please circle the preferred option (Minister of Finance):

Department preferred option	Treasury preferred option	Saving only	No change
<i>\$0.300m net increase</i> \$1.0m operating saving \$1.3m capital expenditure	<i>No net increase</i> \$1.0m operating saving \$1.0m capital expenditure	<i>\$1.000 million saving only</i>	

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

f Fiscal Pressures arising from Forex movements

	<i>\$million - increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 only</i>
<i>Operating (GST excl)</i>					
Department	(0.250)	0.090	0.080	0.040	0.040
Treasury	(0.250)	0.090	0.080	0.040	0.040

22. An expenditure transfer to fund cost increases arising from the depreciation of the NZD. The costs are for international commitments and therefore relatively non-discretionary. Treasury is comfortable with the proposed approach.

Recommendations

Treasury recommends that you:

- (iv) **Support** this initiative at the proposed amount

Agree/Disagree