

Treasury Report: Budget 2009: Votes Economic Development, Energy and Resources

Date:	6 March 2009	Report No:	T2009/505
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Read this report before the Bilateral with Minister of Economic Development and Energy and Resources	7:30 a.m. on 11 March 2009
Associate Minister of Finance (Hon Simon Power)	Read this report before the Bilateral with Minister of Economic Development and Energy and Resources	7:30 a.m. on 11 March 2009

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
James Beard	Manager- Economic Performance Group	[deleted – privacy]	[deleted – privacy]	✓
[deleted – privacy]	[deleted – privacy]	[deleted – privacy]	[deleted – privacy]	
[deleted – privacy]	[deleted – privacy]	[deleted – privacy]	[deleted – privacy]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: No

Treasury Report: Bilateral Briefing for Votes Economic Development and Energy and Resources

Attached is a briefing for the bilateral between the Minister of Finance and the Minister of Economic Development and Energy and Resources at 7:30 a.m. on 11 March 2009 to discuss the Budget initiatives for Votes.

The bilateral briefing will include the following sections for each Vote:

- Overview of the Vote
- Savings component & recommendations
- Emergency pressures & recommendations
- Value for Money & Strategic Direction
- Policy priority initiatives & recommendations

We expect the key issues for discussion within Vote Energy and Resources will be:

- 1) funding to encourage petroleum mining; and
- 2) the scaling up of energy efficiency programmes.

Treasury's view is that the bids relating to these issues in Vote Energy and Resources should not be supported. None of these bids are policy priorities, and further analysis is required on their cost-effectiveness before funding is granted. Treasury does however support an emergency pressure bid within Vote Revenue, which requests a continuation of the tax exemption for off-shore oil rigs.

Recommended Action

We recommend that you **read** the attached briefing and use it as the basis for taking decisions in your bilateral with Hon Gerry Brownlee at 7:30am on 11 March 2009.

James Beard
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Overview of the Vote

VOTE ENERGY AND RESOURCES

- 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 Energy and Resources 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	-	-	(3.257)	-	-
Emergency pressures	-	1.900	1.900	1.900	1.900
Policy priorities	-	18.376	31.813	17.839	17.679
Total funding requested	-	20.276	30.456	19.739	19.597
Crown funded	-	11.900	17.843	5.830	5.670
Levy funded	-	8.376	12,613	13.909	13.909
<i>Capital (GST excl)</i>					
Savings	-	-	-	-	-
Emergency pressures	-	-	-	-	-
Policy priorities	-	-	-	-	-
Total funding requested	-	-	-	-	-

- In addition to the funding currently sought through the budget, outlined in the table above, Treasury officials understand that the Minister for Vote Energy and Resources will:
 - discuss a proposal to establish a New Zealand Insulation Fund, with the following impact on the operating balance:

	<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	-	21.02	36.27	47.53	59.21

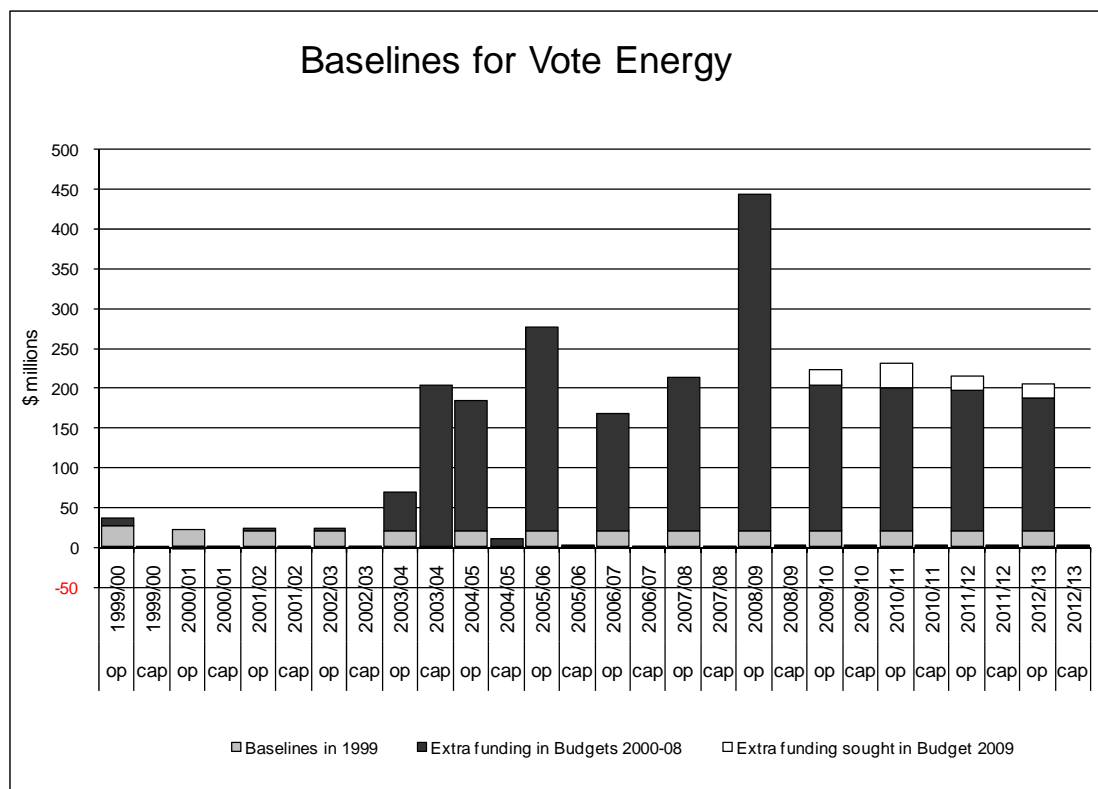
- b) seek agreement to an emergency pressure bid within Vote Revenue, as outlined in CBC Min (09) 4/3, which results in the continuation of a tax exemption for oil rigs, with the following impact on tax revenues:

	<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>
Vote Revenue: Crown Revenue and Receipts – Tax Revenue					
Oil Rig Income Tax Exemption	-	(2.500)	(5.000)	(5.000)	(5.000)

3. Treasury's view on the savings submitted by Vote Energy and Resources is that they are sufficient. The savings in 09/10 represent about 10% of departmental expenses; however as some of these savings involved the removal of specific programmes we would expect there could possibly be ongoing savings from baselines in 10/11 onwards. The fiscal benefit of any further savings is however likely to be limited, as the majority of Vote Energy and Resources baselines are recovered via levies and revenues – i.e. are fiscally neutral (see paragraph 6 below). The savings submitted by Vote Energy and Resources included \$9.887 million of fiscally neutral savings in 08/09 and 09/10, from the Electricity Commission's energy efficiency appropriation.

Analysis of Vote

4. Vote Energy and Resources baselines are shown in the graph below.



5. The large amount of capital expenditure in 2003/04 was due to the purchasing of the Whirinaki Reserve Electricity Plant. The step changes in operating expenditure are primarily due to:
- a) the maintenance and operation of the Whirinaki plant to address security of supply issues (in particular the dry winter of 08/09);
 - b) the inclusion of the Electricity Commission within Vote Energy, and associated costs of market regulation and energy efficiency programmes in 04/05; and
 - c) the inclusion of the Energy Efficiency and Conservation Authority (EECA) programmes in Vote Energy in 08/09.
6. The majority of the growth in baselines has therefore been on the non-departmental side, with only small increases in departmental expenditure – which represents only 7% of the total 08/09 baseline. Furthermore, almost 80% of the non-departmental expenditure is recovered via revenues from electricity sales of the Whirinaki plant or through a levy on electricity consumers, and is therefore fiscally neutral.

Recommendations

Treasury recommends that you:

- (i) Support the savings submitted for Vote Energy and Resources

Agree/Disagree

Emergency Pressures

7. The Minister has submitted an emergency pressure bid for Core Baseline Funding for the Electricity Commission as outlined above. The purpose of this initiative is to increase the capacity within the Electricity Commission to assess transmission

investments and continue to carry out its responsibilities under the Government Policy Statement on Electricity Governance (GPS).

8. Ensuring transmission investments are not unduly delayed by a lack of capacity in the regulatory assessment process is important, and given the recent public concerns with delays to transmission investment Treasury considers that this bid is an emergency pressure and should be funded. While the bid has already been scaled from its original amount of \$2.4million per annum further scaling is possible, but not recommended. The funding is recovered via levy and is therefore fiscally neutral.
9. Treasury considers that it will be necessary to review the appropriations given to the Electricity Commission in light of the forthcoming review of the institutional arrangements for the electricity sector.

Recommendations

Treasury recommends that you:

- (ii) Support the emergency pressure bid submitted for Vote Energy and Resources

Agree/Disagree

10. The Minister of Energy and Resources has also submitted an emergency pressure bid through Vote Revenue: 'Tax exemption for non-resident oil rig operators', which needs your agreement. The initiative seeks funding so that tax exemptions for off-shore oil rigs can continue. The initiative was discussed at the Cabinet Business Committee (see CBC Min (09) 4/3), which authorised the Minister of Finance, Minister of Energy and Resources and Minister of Revenue to make final decisions on extending the tax exemption for a further five years, subject to the cost of doing so being fully met by savings elsewhere.
11. This initiative will have the following impact on tax revenues, and result in a corresponding reduction in savings:

	<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>
Vote Revenue: Crown Revenue and Receipts – Tax Revenue					
Oil Rig Income Tax Exemption	-	(2.500)	(5.000)	(5.000)	(5.000)

Recommendations

Treasury recommends that you:

- (i) Support the emergency pressure submitted for Vote Revenue

Agree/Disagree

Value for Money/Strategic Direction

12. Treasury and the Ministry of Economic Development have discussed possible next steps for Vote Energy and Resources in terms of Value for Money. The one specific area that both departments consider as a possible candidate for further review is the energy efficiency programmes which the Electricity Commission and the Energy Efficiency and Conservation Authority (EECA) operate.
13. The proposed review of the institutional arrangements for the electricity sector will consider the roles and responsibilities of the Electricity Commission, and may lead to the transfer of some of the primarily business energy efficiency programmes to EECA. At the same time, the Minister for Vote Energy and Resources is proposing to scale up existing household retrofits and solar heating programmes within EECA. Before any further funding is allocated to EECA it will be necessary to firstly consider the recommendations of the review, and secondly conduct a comprehensive assessment of the cost-effectiveness of current programmes.

Recommendations

Treasury recommends that you:

- (i) Raise with the Minister of Vote Energy and Resources that before any further funding for EECA is appropriated:
 - a. the findings of the review of the institutional arrangements for the electricity sector are considered, in particular the implications for the energy efficiency programmes run by the Electricity Commission ; and
 - b. MED is directed to undertake a comprehensive assessment of the cost-effectiveness of current programmes and the capacity within EECA and other institutions.

Agree/Disagree

Agree/Disagree

14. The main issues that will affect Vote Energy and Resources in Budgets 2010/11 and 2011/12 are the recommendations from a review of the role and responsibilities of the Electricity Commission. This could lead to reductions in appropriations, including the funding of the Whirinaki Reserve Electricity Plant and potentially the transfer of some funding to the Energy Efficiency and Conservation Authority (EECA), as discussed above.

Vote Energy and Resources – Analysis of Policy Priorities

Vote Energy and Resources has submitted the following policy priority initiatives:

a Acquisition of Petroleum Exploration Data

	<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	-	10.000	15.000	-	-
Treasury	-	0.000	0.000	-	-
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

15. The department seeks \$25 million to continue the funding of seismic data acquisition. The data that is acquired will be publicly available and encourage petroleum exploration within New Zealand's petroleum basins. The funding represents a large increase on the \$3-3.5 million per annum allocated to the current programme over the last two years. The current programme has no further funding available.
16. Treasury considers that this initiative is not a policy priority and should not be supported in the current budget. While the initiative is likely to result in some economic/fiscal benefits to New Zealand, these are difficult to quantify. The initiative seeks funding for three specific seismic data acquisitions. If you wish to support the bid, Treasury would recommend one of the following possible scaled options:
 - Option A: fund only the most cost-effective acquisition (as determined by GNS science) – cost of \$4.690 million over the period
 - Option B: fund the most cost-effective and also the smallest acquisition – cost of \$9.270 million over the period
 - Option C: fund the most cost-effective and also the largest acquisition – cost of \$19.570 million over the period
17. Treasury also notes that supporting the emergency pressure bid for tax exemptions for oil rigs would provide some incentive for seismic ships also, and therefore even without funding this initiative an increase in seismic acquisition is likely.

Recommendations

Please circle the preferred option (Minister of Finance):

Department preferred option	Treasury preferred option	Scaled option A (Tsy 2nd best)	Scaled option B	Scaled option C
\$25 million over the period	\$0 million over the period	\$4.690 million over the period	\$9.270 million over the period	\$19.500 million over the period

b Electricity Commission – System Operator Service Provided Agreement (SOSPA)

	<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	-	6.476	10.613	12.109	12.109
Treasury	-	6.476	10.613	12.109	12.109
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

18. The department seeks funding for the Electricity Commission so that they are able to finalise a contract with Transpower for the upgrading of software that is required for the day-to-day operation of the electricity grid.
19. Treasury considers that maintaining the secure day-to-day operation of the electricity grid is essential for the economy. The initial funding proposal has been reduced by about 30%. Any more scaling would mean that the software could not be purchased.

Recommendations

Treasury recommends that you:

- (i) Support this initiative at the proposed amount

Agree/Disagree

c Solar and Heat Pump Water Heating Programme

	<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	-	1.900	6.100	5.830	5.670
Treasury	-	0.000	0.000	0.000	0.000
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

20. The department seeks funding so that EECA is able to offer household grants for the installation of solar and heat pump water heating units. The funding aims to increase the number of water heating installations from 3,371 in 07/08 to 9,000/year. The funding represents an average doubling in the current annual appropriation.
21. Treasury considers that while 'reinvigorating the solar water sector' was part of the National Party Environment Policy, there are a number reasons why this initiative should not be funded, including:
- there are a number of more cost-effective ways of enhancing energy efficiency, including insulating homes and more efficient and clean heating units;
 - the performance of the current solar water grant programme has been weak (22 loans in 07/08, 500 loans in 08/09); and
 - it is not clear how this grant scheme fits in with the proposed New Zealand Insulation Fund proposal.

Recommendations

Treasury recommends that you:

- (ii) Do not support this initiative

Agree/Disagree

d New Zealand Insulation 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	-	21.02	36.27	47.53	59.21

- The department seeks funding for a New Zealand household insulation fund. This is effectively a scaled-up version of the existing retrofitting programmes and would replace the current interest subsidies programme and grants programmes.
22. Treasury does not support this initiative, as it does not fit the criteria of either an emergency pressure or a policy priority.
23. The late timing of the proposal is also not optimal, as it has not given officials sufficient time to consider what would be an almost 100% increase in energy efficiency funding for EECA. Having said this, the Treasury considers that there are a number of problems with the proposed scheme, including:
- a. the scheme currently has no targeting towards either low income households or households with children or sickness beneficiaries, and therefore the cost-effectiveness is seriously undermined;
 - b. the capacity of service and loan providers to deliver the proposed quantities of support is not clear; and
 - c. the effectiveness of the current grant and subsidy programmes has not been evaluated, and therefore it is difficult to determine whether the funds are being directed to the most effective programmes.

Recommendations

Treasury recommends that you:

- (i) Do not support this initiative

Agree/Disagree

Overview of the Vote

VOTE ECONOMIC DEVELOPMENT

24. 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 Economic Development submitted the following:

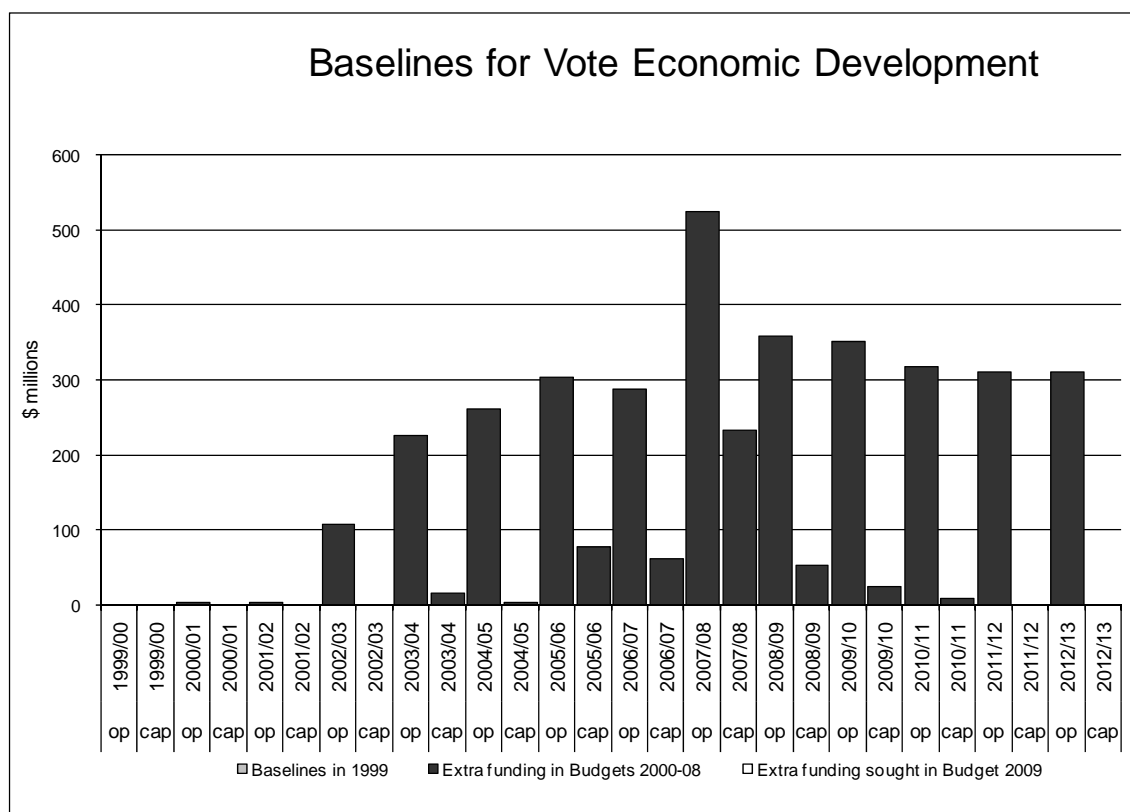
	<i>\$million - increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 & Outyears</i>
<i>Operating (GST excl)</i>					
Savings	(28.300)	(18.210)	(44.900)	(45.300)	(45.300)
Emergency pressures	-	-	-	-	-
Policy priorities	-	-	-	-	-
Total funding requested	(28.300)	(18.210)	(44.900)	(45.300)	(45.300)
<i>Capital (GST excl)</i>					
Savings	(4.000)	(3.000)	(3.000)	-	-
Emergency pressures	-	-	-	-	-
Policy priorities	-	-	-	-	-
Total funding requested	(4.000)	(3.000)	(3.000)	-	-

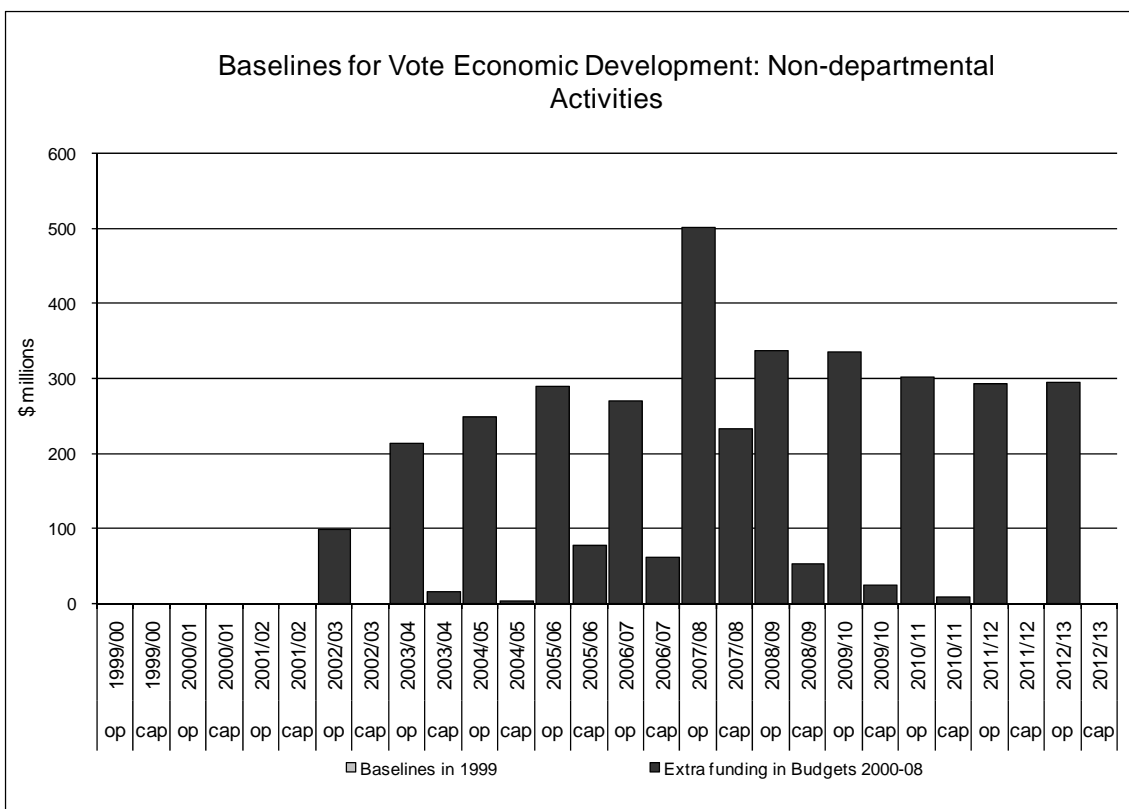
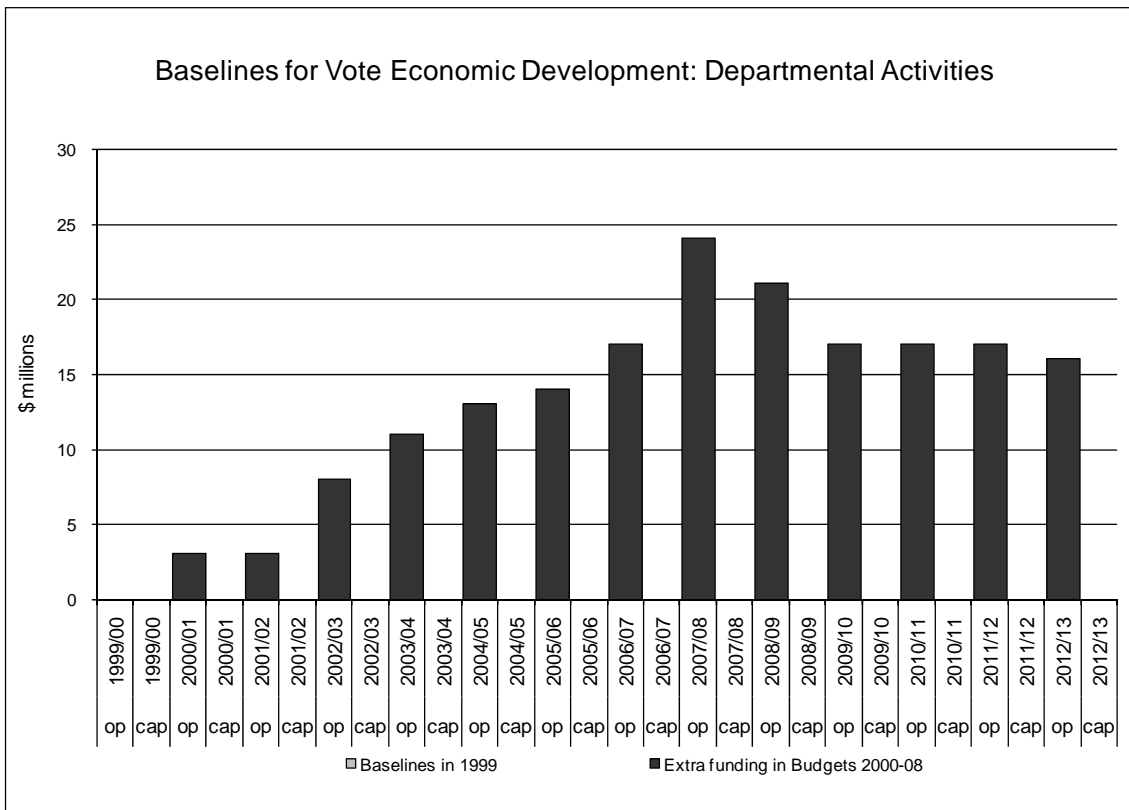
25. Treasury's view on the savings submitted by the Vote is favourable. We consider the Ministry has undertaken a thorough assessment of expenditure within the Vote and have identified a reasonable level of savings. We are aware that there are further areas for potential savings, particularly around some remaining grant programmes and corresponding administration costs, as well as sector and regional development programmes. But we think that this is best considered through the review of business assistance where the programmes can be assessed more fully, based on programme rationale and evaluations to date. We note that this is an ongoing culture shift with regard to government expenditure and we will work with MED to ensure that all spending within the Vote achieves good value for money.

Analysis of Vote

26. Vote Economic Development baselines are shown in the graph below. The Vote, previously called Vote Economic, Industry and Regional Development, was only established at Budget 2000 along with the Ministry of Economic Development; hence no baseline figures from 1999.

27. The Vote grew steadily as the Ministry undertook more functions and, particularly in 2003 when New Zealand Trade and Enterprise was established through merging Trade New Zealand and Industry New Zealand. Specific issues include:
- There was a minor peak in 2005/06 owing to a one-off increase in the Large Budget Screen Development Fund
 - The significant peak in operating and capital in 2007/08 was due to the government's contribution to the redevelopment of Eden Park (capital is a \$190 million loan to the Eden Park Redevelopment Board, operating is \$190 million to impair that loan to a fair value of zero).
 - Growth in capital is largely driven by contributions to the Venture Investment Fund and Seed Co-Investment Fund.





Recommendations

Treasury recommends that you:

- (i) Support the savings submitted for Vote Economic Development
Agree/Disagree
- (ii) Note that a review of business assistance may propose further savings from Vote Economic Development.

Value for Money/Strategic Direction

- 28. The next step in Value for Money for Vote Economic Development is to undertake a review into business assistance. As noted above, officials are in the process of developing Terms of Reference and will report to the Ministers of Finance and Economic Development in the near future.
- 29. The review will assess current programmes based on evaluations already undertaken and will recommend options for future directions of the business assistance programmes. In the short term, this review will investigate spending in Votes Economic Development and Research, Science and Technology. The principles developed in this review could then be applied to other business assistance programmes in Votes Labour, Social Development and Tourism. From the Treasury's point of view, the aim of the review should be to ensure business assistance programmes are effective, generate public benefits, and do not expose the Crown and taxpayers to unacceptable risk.
- 30. The main issues that will affect Vote Economic Development in Budgets 2010/11 and 2011/12 will largely be determined through the business assistance review. If carried out well, the review will set the strategy for business assistance in the coming years. The Ministry will need to assess its role and departmental output expenses in relation to the outcome of the review. We understand that MED are running a further organisation-wide savings exercise for 2010/11.
- 31. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].*

Recommendations

Treasury recommends that you:

- (i) Note that the strategic direction for Vote Economic Development will be driven by the review of business assistance to be run in the early part of 2009.