

Budget Report: Budget 2010: Indicative Shares of the Operating Allowance Cabinet Paper

Date:	19 October 2009	Report No:	BR2010/2
--------------	-----------------	-------------------	----------

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Indicate any changes you want to the attached draft Cabinet paper.	5.00pm, Thursday 22 October 2009
Associate Minister of Finance (Hon Simon Power)	Note the contents of this report.	None
Associate Minister of Finance (Hon Steven Joyce)	Note the contents of this report.	None

Contact for Telephone Discussion (if required)

Name		Telephone		1st Contact
[withheld – privacy]	Senior Analyst Fiscal Management	[withheld – privacy]	[withheld – privacy]	✓
Chris Bunny	Manager, Fiscal Management	[withheld – privacy]	[withheld – privacy]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: Yes

[Budget 2010: Cabinet Paper: Operating Allowance Indicative Shares \(Treasury:1373209v3\)](#)

Budget Report: Budget 2010: Indicative Shares of the Operating Allowance Cabinet Paper

Purpose of Report

1. This report covers a draft Cabinet paper that proposes indicative shares of the operating allowance for Budget 2010 (incorporating the matters discussed by Budget Ministers on 14 October 2010). The report also notes the changes to the Budget 2010 process agreed by Budget Ministers and the impact of those changes on the process.

Background

2. On 21 September 2009 Ministers agreed a 2010 Budget process with the following broad features [CAB Min (09) 34/12 refers]:
 - An initial strategic phase in which the Government collectively sets priorities and allocates shares of the operating allowance to relevant Votes.
 - A separate process for Cabinet to consider options to reduce spending in a discrete number of specific areas, with these savings offsetting the impact of the \$1.1 billion operating allowance on total Government spending.
 - Ministers and Chief Executives working together to align baselines with priorities and report back to Budget Ministers on how they propose to deliver the Government's priorities from within available funding.
 - A multi-year ECC work programme to establish appropriate relativities between areas of expenditure and update baselines to reflect these.
3. Cabinet invited Budget Ministers to report back on 19 October 2009 with an indicative sharing across relevant Votes of new operating funding for Budget 2010 and any grouping of Ministers and Votes for the remainder of the Budget process [Cab Min (09) 34/12 refers]. The draft Cabinet paper attached has been written to meet this requirement.

Budget Ministers Meeting – 14 October 2009

4. Budget Ministers met on 14 October 2009 to set indicative shares of the Budget 2010 operating allowance. Budget Ministers agreed that:
 - The following amounts are to be deducted from the \$1.1 billion Budget 2010 operating allowance, leaving \$550 million available for allocation to Votes:
 - \$128 million to cover the ACC non-earners account funding shortfall;
 - \$200 million to establish a between budget contingency for 2010/11;
 - \$122 million for a “rolling maul” of initiatives to be announced both in Budget 2010 and throughout 2010/11 for the Government's key economic and social priorities; and
 - \$100 million for the operating impacts of capital expenditure decisions.

- The final amount to be allocated will be set in December 2009 and will be informed by the latest economic and fiscal forecasts, detailed examination of Social Sector Votes, Ministers' feedback and their progress in aligning their baselines with priorities.
- Vote Health be indicatively allocated \$300 million and Vote Education \$250 million as the maximum level of the additional funding available.
- At this time no other Vote is to be indicatively allocated additional funding through Budget 2010.
- A detailed examination be undertaken by the respective Vote Minister and their departments, of the pressures and expenditure in each of the key areas of the Social Sector (Health, Education, Social Development and the Justice Votes¹) to determine the adequacy of current funding levels in those Votes.
- The substantial increases in baselines across the board over the last six years provide a significant opportunity for Vote Ministers to reprioritise away from activities which are inefficient, ineffective or inconsistent with where the Government wants to make progress, and so realise significant savings with which to manage pressures and achieve their priorities within their existing baselines.

Process for Detailed Examination of Key Social Sector Votes

5. We propose that the detailed examination of the key social sector Votes be undertaken by the respective Vote Minister and their departments. The reviews are to be completed by 22 December 2009, unless the Vote Minister determines that additional funding will be requested, in which case the reviews are to be completed by 30 November 2009. This is to ensure that there is sufficient time between review submission and Christmas closedown for Cabinet to make any funding reprioritisation decisions that are required. The reviews should include an examination of the pressures in each Vote, where current funding is applied, the options to reduce or stop expenditure within the Vote, an examination of baseline increases since 2005, and a justification for why any increase in funding is needed.
6. Budget Ministers indicated that their expectations in each of the areas are:
 - Votes Health and Education – to be able to manage within their indicative allocation and require no further additional funding in Budget 2010.
 - Vote Social Development – to be able to return funding to the centre from programmes with lower than forecast demand or which have been stopped.
 - Justice Votes – to be able to manage with no additional funding from Budget 2010.

¹ Justice Votes: Attorney-General, Courts, Corrections, Justice, Police, and Serious Fraud.

Risks

7. Excluding the top-sliced items, the operating allowance has been indicatively allocated to two Votes. Although the expectation is that most Votes will manage from within baselines, there is currently growing noise regarding the need for relatively small amounts of additional funding (e.g. MAF have indicated that they are seeking several millions of dollars to either close down or support the operations of Timberlands West Coast). There is a risk that the expectation on managing within baselines is not met and an unmanageable number of requests for additional funding are submitted on 30 November. The additional bids could arise from there being nothing to mop up the 'small beer' funding pressures and, more significantly, as there is seemingly nothing to lose by requesting additional funding.
8. Should this occur it forces the centre (Budget Ministers) to validate whether the requests are bona fide (i.e. the sums sought are legitimate) and reflect a valid view on priorities. Given the time pressures, it will be very difficult to properly analyse more than a handful of bids.
9. Assuming that some of these bids cannot be disproven, then the discussion at Cabinet becomes one where the funding needed is effectively sought from one of three places:
 - By reducing the allocation to Votes Education and Health;
 - By reducing some of the top-sliced funding (e.g. contingency, 'rolling maul fund'); or
 - Through increasing the allocation to more than \$1.1 billion. (Note: when designing the process the last two scenarios were considered unlikely as most Votes were to be allocated of shares of the operating allowance, increasing the effectiveness of peer scrutiny of additional funding requests).
10. To mitigate these risks it is proposed that Vote Ministers who consider that they are unable to deliver priorities and cater for cost pressures from within their baseline advise the Minister of Finance of this in writing by 30 November 2009, together with an examination of baselines increases since 2005, and a justification for why any increase is needed. This analysis would need to be to a level comparable with the detailed examination undertaken by the key social sector Votes.

Next Steps

11. We propose that the paper attached to this report be taken to Cabinet on Tuesday 27 October. Treasury is currently drafting a letter from you to all Vote Ministers informing them of Budget Ministers' expectations for the remainder of the Budget process. We expect that we will have a draft of the letter ready for you by 29 October. We are also preparing a draft paper for you take to Cabinet on 2 November 2009 proposing further details on the process and conduct of the detailed examination of the major social sector Votes.

Recommended Action

We recommend that you:

- a **note** that on 14 October 2009 Budget Ministers agreed that:
 - i. following deductions \$550 million of the \$1.1 billion Budget 2010 operating allowance is available to be allocated to Votes;
 - ii. Vote Health will be indicatively allocated \$300 million and Vote Education \$250 million;
 - iii. at this time no other vote is to be indicatively allocated additional funding in Budget 2010;
 - iv. a detailed examination be undertaken by the respective Vote Minister and their departments, of the pressures and expenditure in each of the key areas of the social sector to determine the adequacy of current funding levels in those Votes;
- b **indicate** if you require any changes to the attached draft Cabinet paper;
- c **agree** the process proposed in this report for the detailed examination of the key social sector votes;
Agree/disagree.
- d **note** that changes to the Budget process have increased the risk that unmanageable bids for additional funding will be received on 30 November 2009;
- e **agree** that to mitigate this risk Votes requesting additional funding on 30 November 2009 be required to provide justification and analysis comparable with the detailed examination to be provided by the key social sector Votes; and
Agree/disagree.
- f **note** that the Treasury is drafting a letter from you to all Vote Ministers informing them of Budget Ministers' expectations for the remainder of the Budget process, and is also preparing a draft paper for you take to Cabinet on 2 November 2009 on the process for the detailed examination of the major social sector Votes.

Chris Bunny
**Manager, Fiscal Management
for Secretary to the Treasury**

Hon Bill English
Minister of Finance