

## **2010 BUDGET PACKAGE**

### **Proposal**

1. This paper seeks approval of the 2010 Budget package.

### **Executive Summary**

2. The impact of the global financial crisis is now abating and the economy has grown over the past nine months. The preliminary economic and fiscal forecasts for Budget 2010 are largely in line with the Half-Year Economic and Fiscal Update, with operating deficits forecast to persist until 2016. Continuing to maintain the Budget allowances at the levels set out in the 2010 Budget Policy Statement is fundamental to ensuring that the rise in net public debt is contained.
3. The Government's focus is on accelerating economic growth and ensuring the economy expands in a more sustainable manner than in recent years. Budget 2010 furthers this in two ways. The tax changes that take effect from 1 October will lift real incomes and improve the fairness of the tax system. The other contribution this Budget makes is better delivery of Government services. Existing spending continues to be redirected to higher priority uses and cost pressures contained. New spending has largely been directed to areas of demographic pressures, notably health and education.
4. The Budget package provides a considerable funding increase for Vote Health (\$500 million in 2010/11 and then around \$470 million per year for the remainder of the forecast period, comprised of \$420 million per year from the operating allowance, around \$33 million per year in reprioritised funding, and \$91 million across the forecast period from underspends) and manages pressures in Vote Education through the provision of an additional \$685 million per year (\$300 million per year from the operating allowance and a further \$385 million per year in forecast changes). In Vote Social Development \$198 million has been committed across the forecast period to improve family and community services. An additional \$38 million per year has been provided from the operating allowance and \$330 million in capital across the forecast period, to manage a range of pressures in the Justice sector and to lift prison capacity.

5. Permanently lifting New Zealand's growth rate and thereby raising future living standards of New Zealanders is best achieved by lifting productivity and competitiveness throughout the economy. Tax reforms are a significant component of the economic growth strategy that will be implemented in this Budget. Other initiatives that will be progressed through this Budget include \$306 million over four years for Research, Science and Technology; \$500 million over four years for the electrification of Auckland rail lines and \$250 million for investment in the rail network; and \$200 million over four years for ultra-fast broadband and \$48 million over four years for broadband in schools.

6. The initiatives to be implemented through Budget 2010 will be funded from the new spending allowances of \$1.1 billion operating per year and \$1.45 billion capital, and baseline savings and reprioritisation of \$1.76 billion across the forecast period.

### **Background**

7. The impact of the global financial crisis is now abating and the economy has grown over the past nine months. The preliminary economic and fiscal forecasts are largely in line with the Half-Year Economic and Fiscal Update, with operating deficits forecast to persist until 2016. Continuing to maintain the Budget allowances at the levels set out in the 2010 Budget Policy Statement is fundamental to ensuring that the rise in net public debt is contained. Concerns around the world about sovereign risk emphasise the importance of maintaining the strength of the Crown balance sheet, particularly in light of New Zealand's high net foreign liabilities.

8. The Government's focus is on accelerating economic growth and ensuring the economy expands in a more sustainable manner than in recent years. This will be an ongoing process over the next three to five years. The deep problems in the economy have accumulated over several years and a similar timeframe will be needed to reverse them. Constraining the growth in government expenditure and returning the operating balance to surplus will support the economy to grow and rebalance.

9. Budget 2010 furthers the Government's focus on sustainable economic growth in two ways. The tax changes that take effect from 1 October will lift real incomes and improve the fairness of the tax system. They will improve incentives to save and help direct investment into more productive areas. The other contribution this Budget makes to accelerating economic growth is better delivery of Government services. Existing spending continues to be redirected to higher priority uses and cost pressures contained. New spending has largely been directed to areas of demographic pressures, notably health and education.

10. These decisions will help tilt the economy away from consumption, borrowing and higher government spending, and towards the pre-requisites for sustained growth of investment, savings and exports.

11. Budget 2010 is about helping families get ahead through the maintenance of services and entitlements; and permanently lifting New Zealand's growth rate through rebalancing the tax system, constraining the growth in government expenditure, and investing in key infrastructure and science.

### The 2010 Budget Package

12. This paper proposes net new spending of \$1.1 billion operating per year and \$1.45 billion capital in total for Budget 2010, as set out in *Table 1* below:

*Table 1: 2010 Budget Package*

	\$million increase / (decrease)						
	Operating						Capital
	2009/10	2010/11	2011/12	2012/13	2013/14	Total	Total
New spending	65	1,319	1,370	1,381	1,390	5,526	1,793
Savings	(251)	(220)	(450)	(432)	(412)	(1,765)	(279)
<b>Net increase</b>	<b>(186)</b>	<b>1,099</b>	<b>921</b>	<b>949</b>	<b>978</b>	<b>3,761</b>	<b>1,514</b>
Allowance	-	1,100	1,100	1,100	1,100	4,400	1,450
<i>Remaining</i>	<i>186</i>	<i>1</i>	<i>179</i>	<i>151</i>	<i>122</i>	<i>639</i>	<i>(64)</i>

13. The \$64 million overspend in the capital allowance has been funded from within the \$1.1 billion operating allowance, and has been incorporated into the operating new spending line of *Table 1*.

14. Of the \$1.1 billion operating allowance, \$115 million per year will be held as a general between-Budget contingency and an average of \$45 million per year as an emerging priorities contingency to enable the Government to respond rapidly to events as they unfold (both changes in the economic and fiscal situation, and emerging policy priorities) as shown in *Table 2* below. As the capital allowance has been overspent there is no capital contingency for between-Budget spending. Any between-Budget capital expenditure will be funded from the operating contingencies.

*Table 2: 2010 Between-Budget Contingencies*

	\$million increase / (decrease)				
	Operating				
	2010/11	2011/12	2012/13	2013/14	Total
General Contingency	115	115	115	115	460
Emerging Priorities Contingency	49	59	35	36	179
<b>Total Contingency</b>	<b>164</b>	<b>174</b>	<b>150</b>	<b>151</b>	<b>639</b>

15. Ministers should only seek funding from the between-Budget contingencies for urgent issues that cannot be deferred to Budget 2011, and will be expected to demonstrate that they have considered opportunities to fund pressures from existing baselines before seeking funding from the contingencies.

### *Helping families get ahead*

16. The key components of the 2010 Budget package that maintain services and entitlements in the major social sector Votes are set out below.

17. Health: \$500 million in 2010/11 and then around \$470 million per year for the remainder of the forecast period, comprised of \$420 million per year from the operating allowance, around \$33 million per year in reprioritised funding, and \$91 million across the forecast period from underspends. This provides a 3.6% funding increase for DHBs (\$350 million per year); funding for primary care; funding for mental health programmes; a bowel cancer screening feasibility study; boosting medical student places; additional funding for subsidised medicines; additional elective surgery; and disability support equipment.

18. Education: \$685 million per year (\$300 million per year from the operating allowance plus \$385 million per year in forecast changes) and \$176 million in capital across the forecast period (\$30 million of which is to be funded by an operating to capital swap within Vote Education). This provides funding to settle collective agreements and other cost pressures in the schooling sector; maintain and extend the Youth Guarantee scheme; implement national standards; invest in Early Childhood Education participation in priority areas; and continue the 21st century schools building programme. In the tertiary sector, \$150 million per year has been reprioritised from student support and capability funding in order to meet demand and cost pressures.

19. Social Development: \$198 million across the forecast period for family and community services, of which \$90 million is to support NGOs to deliver quality services, \$21 million is for initiatives to be announced in this Budget, and \$87 million ring-fenced for other NGO sector initiatives. \$20 million in underspends and \$9 million in reprioritised funding will be used to fund employment initiatives.

20. Justice: \$147 million across the forecast period (\$38 million per year in outyears) and \$330 million in capital across the forecast period to lift prison capacity and fund legal aid restructuring and volumes; increase Family and Youth Court professional services; and relieve cost pressures across the sector.

21. Maori Affairs: \$134 million over the forecast period to implement Whanau Ora, of which \$120 million comes from Vote Social Development.

### *Permanently lifting New Zealand's growth rate*

22. The Government's growth strategy encompasses a wide range of measures with the common theme of permanently lifting our growth rate and raising future living standards of New Zealanders. This is best achieved by lifting productivity and competitiveness throughout the economy. The tax reforms agreed by Cabinet on Monday 12 April are a significant component of the Government's growth strategy that will be implemented in this Budget. Another key plank of the strategy is a continuing focus on a prudent fiscal strategy and getting the Government's own house in order, including curbing the rate of growth in government expenditure. Other initiatives that

contribute to our growth strategy and that will be progressed through this Budget include:

- Research, Science and Technology: \$306 million over four years of new and reprioritised funding for business R&D grants, technology transfer vouchers, research infrastructure and other initiatives as part of the Medium-Term Economic Growth Agenda.
- Transport: \$500 million over four years for the electrification of Auckland rail lines and \$250 million over four years for investment in the rail network.
- Communications: \$200 million over four years for ultra-fast broadband and \$48 million over four years for broadband in schools.
- Economic Development: \$11 million over four years to ensure that the 2011 Rugby World Cup is leveraged for the wider benefit of New Zealand; \$4 million over four years for work to develop New Zealand as an international centre for the managed funds industry and other Economic Growth Agenda projects; and \$3 million to support New Zealand's joint bid with Australia to host the Square Kilometre Array, an international science centre.

#### *Savings and reprioritisation of baselines*

23. The initiatives outlined above will be funded from the new spending allowances for Budget 2010 of \$1.1 billion operating per year and \$1.45 billion capital, and baseline savings and reprioritisation of \$1.77 billion across the forecast period, including:

- ACC: \$175 million over three years of earlier increases to the ACC Non-Earners' Account baseline that, as a result of the latest baseline update, are now no longer needed. This is in addition to the \$128 million indicatively allocated by Cabinet from the Budget 2010 operating allowance in December which is also now not needed.
- Corrections: Around \$26 million per year from internal efficiency savings and performance improvement programmes.
- Education: \$60 million per year in out-years from Early Childhood Education (ECE) savings (including not removing six hour daily limit) and removing current funding rates for ECE services with above 80% registered teachers.
- Tertiary Education: Around \$150 million per year in savings from student support and capability funding, which has been reinvested within the tertiary education sector to meet demand and cost pressures.
- Energy: \$88 million funding for emergency electricity production that was not needed in 2009/10 and unspent Biodiesel Grants Scheme funds.

- Health: Up to \$33 million per year from lower than expected take-up of immunisation; primary care savings (PHO performance programme, Careplus, and PHO management fees); efficiency gains and rationalisation of administration costs; and Ministry of Health staff reductions.
- Maori Affairs: \$12 million per year from efficiencies in the management and administration of the Maori Potential Fund and other operational efficiencies.
- Research, Science & Technology: Up to \$25 million per year in out-years from lower priority research funds (including teacher fellowships and social & economic research), and uncommitted outyears funding.
- Social Development and Youth Development: reducing the level of childcare assistance family income thresholds and removing future CPI indexing of thresholds; reprioritisation of non-departmental funding from a line-by-line review; and other departmental and baseline savings.

24. Continuing to manage within constrained baselines in future Budgets will become increasingly challenging in all Votes. This means that we need to commence implementing different ways of doing business in 2010, so that baselines remain viable and services continue to be delivered to the public.

### **Moratorium on Papers with Financial Implications**

25. Once Budget 2010 has been agreed by Cabinet, the production process must be completed. In order to ensure that the documentation tabled in the House of Representatives on Budget Day is accurate, Ministers are requested not to submit any papers that have fiscal and/or appropriation implications for agreement by Cabinet between now and Thursday 20 May.

### **Publicity**

26. Budget Day is Thursday 20 May. The Office of the Minister of Finance coordinates all communications relating to Budget 2010, including requests for early announcements. The Minister of Finance's written approval is required for any early announcements.

### **Consultation**

27. This paper was prepared by the Treasury. The Budget package described in the paper is based on the indicative allocation agreed by Cabinet in December, submissions made by Vote Ministers in their Baseline Alignment Proposals, and bilateral meetings between Budget Ministers and the Ministers of Health, Education, and Immigration. This package was confirmed by Budget Ministers in a meeting on Wednesday 31 March.

## Recommendations

28. I recommend that Cabinet:

1. agree that the 2010 Budget focus on helping Kiwi families get ahead and permanently lifting New Zealand's growth rate;
2. note the 2010 Budget Policy Statement set an operating allowance of \$1.1 billion operating per year and \$1.45 billion capital in total;
3. note the impacts of the 2010 Budget Package as set out in the table below:

	\$million increase / (decrease)						
	Operating						Capital
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New spending	65	1,319	1,370	1,381	1,390	5,526	1,793
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4. note that the \$64 million overspend in the capital allowance has been funded from within the \$1.1 billion operating allowance;
5. agree to the initiatives for Budget 2010 as set out in the financial recommendations accompanying this paper;
6. agree to delegate authority to the Minister of Finance and relevant Vote Ministers to approve changes to initiatives and appropriations where this proves necessary to finalise the 2010 Budget package;
7. agree to set aside a between-Budget contingency to enable the Government to respond rapidly to events as they unfold:

	\$million increase / (decrease)				
	Operating				
	2010/11	2011/12	2012/13	2013/14	Total
General Contingency	115	115	115	115	460
Emerging Priorities Contingency	49	59	35	36	179
<b>Total Contingency</b>	<b>164</b>	<b>174</b>	<b>150</b>	<b>151</b>	<b>639</b>

8. note that there is no capital contingency and any between-budget capital expenditure will be funded from the operating contingencies;

9. agree that Ministers should only seek funding from the between-Budget contingencies for urgent issues that cannot be deferred to Budget 2011, and will be expected to demonstrate that they have considered opportunities to fund pressures from existing baselines before seeking funding from the contingency;
10. agree that no papers with fiscal and/or appropriation implications should be submitted for agreement by Cabinet between now and 20 May 2010, to ensure that Budget Day documentation is accurate;
11. note that all Budget Day communications are co-ordinated by the Office of the Minister of Finance, and that the Minister of Finance's written approval is required for any early announcements; and
12. agree that until the Appropriation (2010/11 Estimates) Bill is enacted, expenses or capital expenditure against appropriations set out in the 2010/11 Estimates and being sought in that Bill may be met from Imprest Supply.

Hon Bill English  
**Minister of Finance**

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