Office of the Minister of Finance

Chair
CABINET

BUDGET 2010 SUPPLEMENTARY PAPER – NEW MULTI-YEAR APPROPRIATIONS IN BUDGET 2010, SUMMARY OF BASELINE UPDATES AND OTHER TECHNICAL MATTERS

Proposal

1. This paper fulfils the requirement of the Cabinet Office Circular CO (09) 6 "Guidelines for Changes to Baselines" to:

- Report to ECC regarding new Multi-Year Appropriations (MYAs) in the Budget; and

- Report to ECC regarding the impact of Baseline Updates.

2. The paper covers new MYAs, including three new MYAs in Vote Housing as part of a test of a more flexible fiscal management system, the fiscal impact on the October and February Baseline Updates, as well as a number of technical issues requiring Cabinet decisions as part of Budget 2010.

3. This paper has been submitted directly to Cabinet, rather than ECC, so that it can be considered alongside the Budget Cabinet Paper, also due for Cabinet consideration on April 19.

Executive Summary

4. This paper covers new Multi-Year Appropriations (MYAs) being established in Budget 2010, summarises the impact of the October and February Baseline Updates and seeks Cabinet agreement to a number of technical matters requiring agreement as part of the 2010 Budget. The paper should be considered alongside the 2010 Budget Package paper, also due for Cabinet consideration on April 19.

5. Budget 2010 includes the establishment of six new MYAs in Votes Climate Change, Economic Development, Housing (3) and Treaty Negotiations.

6. The new MYAs in Vote Housing are part of a trial of a more flexible approach to financial management. The paper proposes that the more flexible approach be tested in the departmental appropriations in Vote Housing, beginning in the 2010/11 year. The paper proposes that the test introduce more flexibility by:

- Converting three existing departmental annual appropriations in Vote Housing into MYAs beginning on 1 July 2010; and
- Extending Cabinet delegations to cover a wider range of transactions for two annual appropriations in Vote Housing.

7. If agreed, the test period will be closely monitored by Central Agencies and the Senior Executives Group to manage risks and to consider the suitability of the tested approaches for wider roll-out to other Votes in the future.

8. Both the October Baseline Update (OBU) and February Baseline Update (FBU) are technical updates to capture final decisions and forecasts that joint Ministers (the Minister of Finance and the Minister responsible for the appropriation) can approve under delegated authority from Cabinet [CO (09) 6 refers]. Overall, the combined impact of the OBU and the FBU was to decrease net debt by $44 million between 2009/10 and 2012/13.

9. I intend to present a full description of the economic and fiscal outlook, incorporating the effects of all policy decisions and all forecasting changes to Cabinet on Monday 3 May.

New Multi-Year Appropriations in Budget 2010

10. The Budget Cabinet paper, to be discussed at Cabinet on 19 April, includes six new MYAs. These are summarised in the table below:

Vote	Appropriation	New
Climate Change	Land Use and Carbon Analysis System	Annual appropriation converted into MYA
Economic Development	Rugby World Cup Leverage and Legacy	New appropriation
Housing	Building Regulation and Control	Annual appropriation converted into MYA
Housing	Occupational Licensing	Annual appropriation converted into MYA
Housing	Residential Tenancy and Unit Title Services	Annual appropriation converted into MYA
Treaty Negotiations	Historical Treaty of Waitangi Settlements 2010-2014	As in previous years, replacing the existing 2009-2013 MYA with a new MYA for 2010-2014

New MYA in Vote Climate Change

11. The new MYA is a transfer of funding under the previous annual appropriation "Carbon Monitoring Programme". This was created to give flexibility to the timing of the development of a carbon accounting system.

New MYA in Vote Economic Development

12. The new MYA in Vote Economic Development will support a programme of events and festivities both within New Zealand and offshore focussed on leveraging off the Rugby World Cup and creating a lasting legacy for New Zealand.

New MYAs in Vote Housing

13. The new MYAs in Vote Housing are part of a trial of a more flexible approach to financial management. The more flexible approach will be tested in the departmental appropriations in Vote Housing, beginning in the 2010/11 year.

14. It is intended that a more flexible system of financial management will provide the following benefits:

- Provide the right incentives and tools to improve agency performance and lift productivity;
- Improve agency management of capital assets by extending the focus beyond annual investment to encompass whole of life costs and benefits;
- Strengthen the focus on baseline spending; and
- Streamline the Budget process.

15. I propose that increased flexibility should be tested in two ways, as summarised in the boxes below:

More widespread use of multi-year appropriations

The detailed financial recommendations accompanying the Budget Cabinet paper seek agreement to the creation of three new MYAs (created by rolling up the value of the current forecast baseline for the relevant years):

- Building Regulation and Control (Minister for Building and Construction – funded by Revenue Other);
- Occupational Licensing (Minister for Building and Construction – funded by Revenue Other); and
- Residential Tenancy and Unit Title Services (Minister of Housing – funded by interest on Tenancy Bonds, topped up by Revenue Crown).

These appropriations require flexibility to manage variations in external environment (industry cycles impacting levy and fee revenue). They are in areas where investment in business improvements can result in long-term performance gains.

MYAs will be fixed for the full 3 financial years with a high hurdle required before any adjustments are approved. Adjustment would be possible in response to factors entirely external to the department that could not have been contemplated at time MYA was established but will require ECC/Cabinet approval.
Make greater use of Cabinet delegations to approve transfers across years for departmental outputs. For the Sector and Regulatory Policy (Minister for Building and Construction) and Performance Monitoring and Advice – Housing New Zealand Corporation (Minister of Housing) departmental appropriations in Vote Housing, this paper seeks the following delegations from Cabinet:

Delegation to	To approve what	Limit on delegation
Minister responsible for appropriation	Approve transfers within an appropriation between financial years	Not exceeding 5% of the amount of the appropriation in the financial year from which the transfer is being made
Minister responsible for appropriation and Minister of Finance jointly	Approve transfers within an appropriation between financial years	Up to an additional 5% (that is, a total of 10%) of the amount of the appropriation in the financial year from which the transfer is being made
Minister responsible for appropriation	Approve transfers between appropriations and between financial years	Not exceeding 5% of the amount of the larger appropriation in the financial year from which the transfer is being made
Minister responsible for appropriation and Minister of Finance jointly	Approve transfers between appropriations and between financial years	Up to an additional 5% (that is, a total of 10%) of the amount of the larger appropriation in the financial year from which the transfer is being made

16. Central agencies and other departments will remain closely involved during the testing period to manage risks associated with the project by monitoring progress and testing whether adjustments need to be made. This will include the Chief Executive of the Department of Building and Housing reporting periodically to the Senior Executives Group (SEG) and Ministers responsible for appropriations in Vote Housing regarding progress.

17. The table below sets out potential productivity and performance improvements that can be expected in return for application of a multi-year approach. These should be seen as tentative and high-level at this stage, and will be confirmed and agreed in greater detail with Joint Ministers before the start of the 2010/11 financial year.

Appropriation	*Improvement*
Building Regulation and Control	Improved levels of service for same or reduced fee levels.
Occupational Licensing	Improved performance specification. Reduction in fee levels over time in real terms for same volume of service. Improved timeliness across services.
Residential Tenancy and Unit Title Services	Reduced need for revenue Crown due to business cycle. Service level improvements for same or less revenue.
Sector and Regulatory Policy	Improved performance specification and quality of advice. For example, regular review by NZIER and improvement in rating, also look for other ways to measure quality of advice.
Performance Monitoring and Advice – Housing New Zealand Corporation	

Wider application of more flexible financial management

18. Any plans to bring more departments into testing the multi-year approach for Budget 2011 will need to be made well in advance of having detailed results about the success of the test in Vote Housing. The possible introduction of any new Votes into the trial will need to consider the following information:

- DBH interim report on test period – although only limited provisional information is likely to be available after 6-7 months.
- Assessment of any required changes based on interim test period results.
- As assessment of the alignment of the existing baseline with Government priorities.
- Suitability of performance measures – need robust performance measures if more flexibility is to be rolled out more widely.
- Any changes in the Budget process for Budget 2011.

New MYA in Vote Treaty Negotiations

19. As has happened in previous years, the existing MYA for Historical Treaty of Waitangi Settlements 2009-2013 is being replaced with a new MYA covering the period 2010-2014. The amount of this new MYA is consistent with the amount already included in the fiscal forecasts for settlement of historical Treaty of Waitangi claims over this period.

Impact of February and October Baseline updates

20. Both the October Baseline Update (OBU) and February Baseline Update (FBU) are technical updates to capture final decisions and forecasts that joint Ministers (the Minister of Finance and the relevant Minister responsible for the appropriation) can approve under delegated authority from Cabinet [CO (09) 6 refers]. For the OBU this encompasses changes between April and late October 2009, and for the FBU it covers changes between late October 2009 and February 2010.

21. Changes in expenses arising from changes in forecast benefit expenses in Vote Social Development and forecast changes to the non-departmental appropriations for Vote Revenue, as well as changes in tax revenue, are completed in a process separate from the baseline updates. I intend to present a full description of the economic and fiscal outlook, incorporating the effects of all policy decisions and all forecasting changes to Cabinet on Monday 3 May.

22. Many OBU and FBU changes impact on the operating balance and debt tracks. An indication of the overall impact of the OBU and FBU on the fiscal position is set out in Table 1 below:

Table 1: Impact of OBU 2009 and FBU 2010 on net debt

	$ thousands				
Brackets means a decrease in operating balance and increase in net debt	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**
Operating impacts from FBU and OBU on net debt	1,606,798	(297,828)	(185,262)	(4,528)	1,024
Capital impacts from FBU and OBU on net debt	20,939	(29,703)	(146,018)	(57,982)	(4,040)
Net impact of Vote Finance guarantees and indemnities in OBU on net debt	(765,000)	(434,000)	186,000	154,000	-
Annual impact of OBU and FBU on net debt	862,737	(761,531)	(145,280)	91,490	(3,016)
Cumulative impact of OBU and FBU on net debt	862,737	101,206	(44,074)	47,416	44,400

23. Overall, the combined effect of the OBU and the FBU was to decrease net debt by $44 million between 2009/10 and 2012/13.

24. On the operating side, while there were a number of significant forecast increases in expenses, the net operating impact was more than offset by decreases in other categories of expenses and forecast increases in revenue. Some of significant items are described below.

Changes in Vote Education

25. One of the largest groups of forecast changes, both in the OBU and FBU, was in Vote Education. Total forecast changes across the period from 2009/10 to 2013/14 totalled over $1 billion. As an interim measure, a proportion of these forecast changes are to count against Vote Education's $300 million Budget 2010 allocation. The forecast changes that will *not* count against the Budget 2010 allocation relate primarily to items where the Ministry of Education has less direct control over costs, for example, those associated with student volume growth in schools. As a result, the 2010 Budget Package includes an additional $300 million per year in Vote Education from the operating allowance and a further $385 million per year in forecast changes.

26. The main items that have been included as forecast changes through the baseline updates were in Early Childhood Education (ECE) and primary school expenditure. These are largely due to significant increases in the number of ECE services receiving higher funding rates associated with having 100% registered teachers or 80-99% registered teachers; and due to forecast increases in volume of hours associated with population growth. Forecast changes in primary school expenditure have been affected by a change to the way school rolls are counted for funding purposes, and the effects of this change were first seen in OBU 2009.

27. At a bilateral meeting on 25 March 2010, the Ministers of Finance and Education agreed that in the future, all forecast changes would 'count' against Vote Education baselines and future Budget allocations. This will make the total amount of additional funding going into Vote Education more transparent and allow more informed trade-offs to be made between items of expenditure.

Changes in Vote Finance

28. There was a set of transactions in Vote Finance in the OBU that did not affect the operating balance but did affect debt. These relate to the payments in respect of guarantees and indemnities given under the Crown Deposit Guarantee Scheme, as well

as the anticipated recovery of assets from entities in default. These two items did not affect the operating balance, as they had already been ‘booked’ in the Crown Financial Statements for the 2008/09 year. Nevertheless, the net impact does affect residual cash, and therefore debt, in the years where the receipts and payments are expected to occur.

29. In the FBU, for Vote Finance, the net effect of reductions in the grossing up of revenue from defaulted organisations, as well as the reduction in expenses in the gross amount of guarantee payments on default of organisations, resulted in a decrease in net debt of around $100 million across the forecast period.

Return of Savings in Baseline Updates

30. A number of departments returned savings as part of the FBU process, with $35 million being returned in the 2009/10 financial year and just over $1 million in total in the outyears.

Changes outside the authority of joint Ministers

31. There were several items proposed by Vote Ministers in the FBU and OBU that fell outside the scope of delegations to joint Minister approval, as set out by Cabinet Office Circular CO (09) 6. My response letters to Ministers set out these issues in detail. The issues have been considered as part of the production of Budget 2010 and incorporated into the detailed financial recommendations.

32. The October Baseline Update included a technical change in Vote Education which is, in effect, a Fiscally Neutral Adjustment between two Benefits and Other Unrequited Expenses (BOUE) appropriations. These adjustments are appropriate and of a technical nature as the affected appropriations are not demand-driven and are more like output expenses. This paper notes that these items are clearly labelled as Fiscally Neutral Adjustments in future.

Other Technical Matters requiring Cabinet Consideration

Government Superannuation non-funding employer contribution rates

33. As required under the Government Superannuation Fund Act, the Government Actuary (GA) has set new “funding” [1] employer contribution rates for the Government Superannuation Fund (GSF) for 2010/11. In addition, and consistent with past practice, the GA has also recommended new “non-funding” employer contribution rates for the government to apply to non-funding employers (largely government departments), as set out in the table below. Most rates have seen significant increases, for example the general rate has gone from 6% to 10.7%. These rates may remain high for the foreseeable future.

[1] Funding employers are a range of arms-length Crown agencies (e.g. SOEs) and private companies such as Telecom and Contact who used to be part of the core Crown and still employ some GSF members

GSF Scheme	Current employer subsidy rate	Recommended employer subsidy rate effective from 1 July 2010	Increase
	% contributor salaries	*% contributor salaries*	*% contributor salaries*
Armed Forces	15.4%	25.1%	9.7%
General	6.0%	10.7%	4.7%
Police	16.1%	19.1%	3.0%
Prison Services	0.0%	0.0%	0.0%

34. I propose accepting the GA's new non-funding rates. However, in order to give departments time to manage the increased costs that will result (of around $25 million in total p.a.), I propose to allow departments to seek a baseline adjustment in the 2010 October Baseline Update for the 2010/11 impact only. The adjustment is to cover increased costs associated with the rate rises that have not been passed on to employees whose GSF payments are included as part of a total remuneration package (compensating departments for costs that they will pass onto employees would represent a windfall gain to those departments). Compensating departments in this instance is fiscally neutral as departments are reimbursing the centre for contributions it is already making to the GSF.

Consultation

35. Departments with new MYAs in Budget 2010 have been consulted during the production of the Budget. The Department of Building and Housing has been closely involved in the development of the trial of greater flexibility around financial management in the departmental appropriations in Vote Housing. The members of the Senior Executives Group have also been consulted about the trial of greater flexibility around financial management.

36. Following submissions from Vote Ministers, I confirmed all changes in baselines in both the October and February Baseline Updates with Vote Ministers via response letters. Treasury officials discussed any technical issues regarding proposed changes with the relevant departments for both baseline updates.

Financial Implications

37. The financial recommendations of the changes discussed in this paper are incorporated in the detailed financial recommendations accompanying the Budget Cabinet paper. There are no financial implications arising from the new MYAs in Votes Housing and Climate Change as they are created by rolling up the value of the current forecast baseline for the relevant years. The new Vote Treaty Negotiations MYA has no financial implications.

38. The overall financial implication of the changes to baselines approved as part of the October and February Baseline Updates was a decrease in net debt of $44 million between 2009/10 and 2012/13.

39. Agreement to the new “funding” employer contribution rates for the Government Superannuation fund for 2010/11 will incur additional costs of around $25 million p.a. when departments seek a baseline adjustment for the 2010/11 impact only in the 2010 October Baseline Update.

Human Rights

40. There are no human rights implications associated with this paper.

Legislative Implications

41. The new MYAs described in this paper will be included in the Appropriation (2010/11 Estimates) Bill or the Appropriation (2009/10 Supplementary Estimates) Bill, both to be introduced into Parliament on Budget Day.

Regulatory Impact Analysis

42. A regulatory impact analysis has not been completed for this paper.

Recommendations

43. I recommend that Cabinet:

1. note that the detailed financial recommendations in the Budget Cabinet paper to be considered by Cabinet on 19 April 2010 include the introduction of Multi-Year Appropriations (MYAs) for the following appropriations:

Vote	Appropriation
Climate Change	Land Use and Carbon Analysis System
Economic Development	Rugby World Cup Leverage and Legacy
Housing	Building Regulation and Control
Housing	Occupational Licensing
Housing	Residential Tenancy and Unit Title Services
Treaty Negotiations	Historical Treaty of Waitangi Settlements 2010-2014

2. note that the financial recommendations creating the new MYAs described in recommendation 1 above are incorporated into the 2010 Budget Package Cabinet paper due for consideration at Cabinet on 19 April;

3. agree to introduce the following increased delegations in respect of the Vote Housing departmental output expense appropriations Sector and Regulatory Policy (Minister responsible for appropriation: Minister for Building and Construction) and Performance Monitoring and Advice – Housing New Zealand Corporation (Minister responsible for appropriation: Minister of Housing) as part of a trial of a more flexible approach to financial management in the departmental output expense appropriations in Vote Housing;

Delegation to	To approve what	Limit on delegation
Minister responsible for appropriation	Approve transfers within an appropriation between financial years	Not exceeding 5% of the amount of the appropriation in the financial year from which the transfer is being made
Minister responsible for appropriation and Minister of Finance jointly	Approve transfers within an appropriation between financial years	Up to an additional 5% (that is, a total of 10%) of the amount of the appropriation in the financial year from which the transfer is being made
Minister responsible for appropriation	Approve transfers between appropriations and between financial years	Not exceeding 5% of the amount of the larger appropriation in the financial year from which the transfer is being made
Minister responsible for appropriation and Minister of Finance jointly	Approve transfers between appropriations and between financial years	Up to an additional 5% (that is, a total of 10%) of the amount of the larger appropriation in the financial year from which the transfer is being made

4. agree that any increases to appropriations in Vote Housing arising through the transfers provided for in recommendation 3 above be included in the Appropriation (Supplementary Estimates) Bill for the relevant year;

5. agree that until the relevant year's Supplementary Estimates are enacted, any increases to appropriations in Vote Housing arising through transfers provided for in recommendation 3 above be made under Imprest Supply;

6. note that the new Multi-Year Appropriations will be included in the Appropriation (2010/11 Estimates) Bill or the Appropriation (2009/10 Supplementary Estimates) Bill;

7. note that the combined impact of the October Baseline Update and the February Baseline Update was to decrease net debt by $44 million between 2009/10 to 2012/13;

8. note that future technical changes in Vote Education BOUE appropriations be labelled as Fiscally Neutral Adjustments in the future, provided they are of a technical nature, are not demand-driven and are fiscally neutral;

9. accept the Government Actuary's recommendations for Government Superannuation Fund non-funding employer contribution rates to apply from 2010/11;

10. agree that Departments may seek a baseline adjustment in the 2010 October Baseline Update only for increased costs in the 2010/11 year for the impact associated with the rate rises that have not been passed on to employees whose GSF payments are included as part of a total remuneration package;

11. delegate to the Minister of Finance the authority to approve adjustments in the 2010 October Baseline Update to alleviate the 2010/11 impact of the rate rises on departments and on the handful of non-funding entities that are not departments on a case by case basis, if the need arises.

Hon Bill English
Minister of Finance

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