

Hon Anne Tolley
Minister of Education
Minister for Tertiary Education
Minister Responsible for Education Review Office
Parliament Buildings
WELLINGTON

Dear Anne,

As outlined in the *Budget 2010: Indicative Share of the Operating Allowance* Cabinet paper discussed on 2 November, I committed to write to you providing further details to assist you for the remainder of the 2010 Budget process.

You are aware that we continue to face a tight economic and fiscal environment, where the need for restraint is still necessary. Departments have received significant baseline increases over the last few years, so Vote Ministers are encouraged to look at current baselines as the first source of funding for any new priorities, or should existing programmes require increased funding.

As agreed by Cabinet, your indicative operating allocation for Budget 2010 is as follows:

- Vote Education: \$250 million
- Vote Education Review Office: \$0 million

There still remains an outstanding question about the extent to which items that have historically been forecast driven should remain as such. As you may be aware, Vote Education has a much wider range of items treated as forecast changes than other Votes. I suggest that we have a discussion around the treatment of these changes for both the 2009/10 October Baseline Update and the future.

I should mention that the indicative allocations outlined in this letter could potentially differ from those that we finally agree for Budget 2010. There are a number of factors that may influence the final allocations, such as:

- The detailed examination of various social sector Votes' baselines. Currently, as agreed by Cabinet on 2 November, the requirement to complete a detailed examination of the baselines only applies to Votes Education, Health, Social Development and Justice sector Votes¹. The objective of the detailed examination of these Votes is to ensure that these Votes can deliver priorities within their current baselines and any indicative allocation;

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

- The fact that some Votes may not be able to deliver on their priorities within existing baselines and may write to me seeking increased funding after carrying out a detailed examination of their Vote's baselines, in line with that expected of the social sector Votes;
- Should a Vote Minister be successful in their request for additional funding, this funding will necessarily result in either existing indicative allocations being reduced, or the reduction of centrally held provisions, e.g. the between Budget contingency;
- Ministers' feedback and their progress in aligning their baselines with priorities; and
- *[Deleted in order to maintain the effective conduct of public affairs through the free and frank expressions of opinions].*

Detailed Examination of Social Sector Votes

Cabinet agreed to a *detailed examination* of the social sector Votes to determine how well these Votes are placed to meet the challenges and expectations in their areas. These reviews are to be completed by 21 December 2009, unless the respective Vote Minister determines that additional funding will be required. In this case, the respective review needs to be completed by 30 November 2009. The detailed examinations are to be conducted by the Vote Minister and department concerned, but Vote Ministers may ask me for supplementary assistance from the Treasury.

The detailed examination of these Votes should include a reconciliation of where baseline increases have been applied in each Vote and what value has been obtained. Treasury has developed a terms of reference of the essential information that Vote Ministers must include in the detailed examination of baselines. The terms of reference are attached to this letter.

Process for All Other Votes

The indicative funding allocations agreed by Cabinet means that the majority of Ministers will not receive any *new* marginal funding increases through this process. Given the substantive baseline increases over the last few years for the majority of Votes, Ministers will be expected to reprioritise from existing baselines to find savings that can be used to manage pressures and achieve their priorities from existing funding.

Vote Ministers should use their baselines to meet their highest priorities. However, there may be instances where some low priority, but still valuable programmes cannot be funded from baselines. In these cases, Vote Ministers are invited to submit to me a request for additional funding, accompanied by a detailed examination of their Vote consistent with those requested of the social sector Votes, by 30 November. This will allow Cabinet to consider these proposals and agree any changes to baselines prior to Christmas.

Baseline Alignment Proposal

All Vote Ministers, including those who will be completing a detailed examination of their Votes at the end of 2009, must submit a Baseline Alignment Proposal by 8 March 2010. This proposal shows how the baseline will be used to meet priorities, detailing any changes that need to be made. These submissions will be considered by Budget Ministers to prepare the final Budget Cabinet paper. More information on how these proposals should be put together will appear in the Budget guidance released by Treasury. The template will be loaded on CFISnet and will be attached to the guidance.

Increases in Policy Capability

One area of spending where I would encourage you to focus on is policy advice. I note that you found some savings in the policy advice functions of both the Ministry of Education and the Tertiary Education Commission in Budget 2009. This was on top of savings in other functions of these agencies, which brought total agency savings to \$25.9 million in outyears (\$18.5 million for the Ministry and \$7.4 million for the Tertiary Education Commission). Nevertheless, ensuring that all spending on education policy advice and other back office functions is necessary should remain a priority.

Full Time Equivalent employees in the public service have increased by 10,351 between 2003 and 2008. It is reasonable to assume that a proportion of these are policy advisors. The Ministry of Education had a 38% increase in staff numbers between 2003 and 2008, and the Education Review Office had a 23% increase in that time.

Individual departments and crown entities have information on their increases in both numbers of policy advisors and analysts and the cost of policy advice. Vote Ministers may want to ask their departments and crown entities about growth in number and cost of policy advisors.

Questions that you may want to ask are:

- How much does the agency spend on policy advice?
 - What is the trend information on this spending since 2003?
 - For departments, what percentage is this of the total *departmental* spend? (i.e. excluding non-departmental appropriations)
 - Has the percentage changed since 2003?
- How many FTEs are dedicated to policy advice? How has this number changed since 2003?
- Has there been a commensurate increase in the quantity/quality of policy advice over this time and do you need to continue purchasing the same quality/quantity of policy advice?

Savings

The general rule for savings is that they can be retained in a Vote to manage pressures and achieve Ministerial priorities. However, there are two refinements to this rule:

- If a saving is generated by reducing or stopping a major programme or activity, it requires Cabinet approval. Cabinet will determine the proportion of the saving to be retained within the Vote and that to be returned to the centre.
- Where a saving has been generated by efficiency improvements or where a Vote Minister has actively decided to reduce or stop a programme or activity, the saving can be retained in the Vote. Where active management decisions to stop programmes or activities have not been taken, such as underspends from reduced volume or demand, these savings are to be returned to the centre.

Capital

A similar process will be run for capital as in Budget 2009. This will involve Ministers submitting business cases for investment against our stated aim of using improvements in national infrastructure to drive productivity growth. At this early stage, there are a number of large commitments which will be difficult to fit within the capital allowance of \$1.45 billion. This will put a premium on finding innovative ways to manage our balance sheets and deliver services.

Guidance

Treasury will release the Budget 2010 guidance for departments, which outlines in detail how the process will work and the expectations on departments. This guide will be available both on the CFISnet and the Treasury website.

Yours sincerely

Hon Bill English
Minister of Finance

Cc:

Ms Karen Sewell – Chief Executive and Secretary for Education
Dr Graham Stoop – Chief Executive and Chief Review Officer

Terms of Reference for Detailed Examination of Vote Education

Cabinet has agreed to an indicative allocation to Vote Education for Budget 2010 of \$250 million per year as the maximum level of the additional funding available in addition to existing annual baselines.

In managing to this allocation:

- All costs that will impact on the Crown's Operating Balance need to be managed within the value of existing annual baselines and the allocation;
- The indicative allocation is the maximum for average annual net increases in operating baselines within the 4-year forecast period for Budget 2010, and the upper limit for net baseline increases beyond the 4-year forecast period.

The Minister of Education and the Ministry of Education are to undertake a detailed examination of the priorities, pressures and existing expenditure in Vote Education to assist in aligning baselines to Government priorities, provide Ministers with assurance of the department's ability to manage within baselines, and identify where additional resource should be directed.

The review is to be submitted to Budget Ministers via the Minister of Finance by **21 December 2009**, unless the Minister of Education wishes to make a case that more than an additional \$250 million is required for Vote Education, in which case the review is to be submitted by **30 November 2009**.

Terms of Reference:

The following are the terms of reference for the review of Vote Education:

- Detail how all increases to the Vote since 2005 have been applied and what value has been obtained from that additional expenditure;
- Demonstrate that they have reviewed all areas of expenditure within the Vote and identified any that are not consistent with this government's priorities;
- Demonstrate how pressures facing the Vote will be handled within the funding available to the Vote (or demonstrate that they cannot be handled within the funding available);
- Demonstrate that they have reviewed the number of policy advisors in and the cost of policy advice provided by their department(s) and whether some reduction in that number or cost can be made; and
- Demonstrate that any fiscal savings expected as a result of the department implementing its performance improvement actions have been taken into account.