

Treasury Report: Budget 2010 Design Options

Date:	18 August 2009	Report No:	
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Discuss this report with officials at Fiscal Issues on 19 August 2009	Wednesday 19 August 2009, 4.30pm

Contact for Telephone Discussion (if required)

Name	Position	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: No

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Executive Summary

The Budget process has traditionally been broken into three phases:

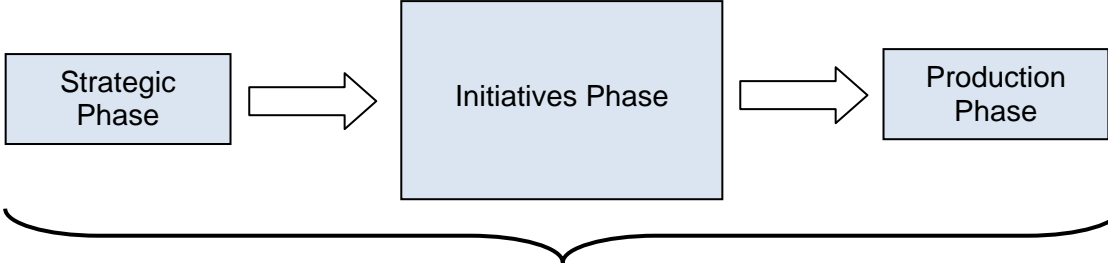
- *Strategic Phase* – conducted over the period September to December annually, in which the Government determines its high level priorities for the forthcoming Budget, and Vote Ministers and Chief Executives review the existing base of funding to ensure that it is delivering value for money and is aligned with Government priorities. This phase culminates in the publication of a budget policy statement (BPS) in mid-December.
- *Initiatives Phase* – in which Vote Ministers (assisted by departments) submit bids to fund cost pressures and policy proposals in late January / early February. These bids are discussed by the relevant Vote Minister and the Minister of Finance in a short bilateral meeting. The Minister of Finance then pulls together an overall budget package which is taken to Cabinet for approval in mid-April.
- *Production Phase* – in which the documents required to give effect to the Budget decisions taken by cabinet are prepared and presented in the House on Budget Day (mid to late May in recent years).

It has been apparent for many years that there are some critical weaknesses in this process. The strategic phase has never operated well as the quality of the strategic planning and review of baselines undertaken by Vote Ministers and Chief Executives has been immensely variable. The focus of the Budget has universally been on the allocation of new marginal funding (leading to an inevitable rise in Government expenditure), and consequently too much time and effort being put into the initiatives phase. Finally, the adversarial nature of the bilateral process has often not supported collective ownership of the process and decisions. All of these issues were identified in the Budget 2009 Process Review (T2009/1817 refers). Additionally in 2009, the difficulties experienced with the strategic phase were compounded by the timing of the General Election and the formation of the new Government.

In response to the review and with regard to the long-running weaknesses in the Budget process we have developed two proposals for a redesign of the Budget process for 2010. These are summarised in the graphic overleaf and described further in the main body of this report. Additionally, we will discuss both options with you at Fiscal Issues on Wednesday 19 August. In short, the options we propose are:

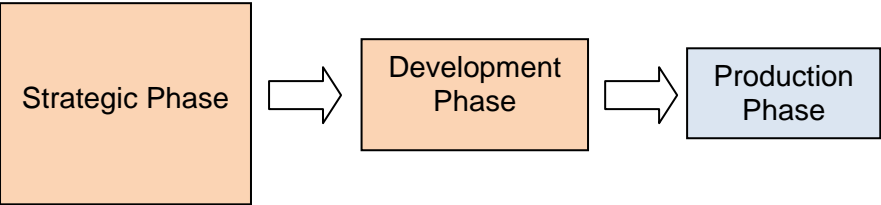
- *Option 1: Improved Status Quo.* This option includes a much stronger strategic phase, in which ministers set policy priorities and categorise votes as high scrutiny (key votes with pressures that are unlikely to be able to be managed within baselines), self-managing within baselines, or self-managing –x (within lower baselines). The operating allowance and savings would be used to fund policy priorities. There would not be any bottom-up policy bids nor bilateral process. Ministerial teams would determine the delivery mechanism for policy priorities.
- *Option 2: Baseline Focus.* This option also includes a strong, priority-setting strategic phase. The operating allowance is allocated to relevant appropriations up-front on a proportional basis. Ministers and Chief Executives work together to align baselines with priorities and report back to Cabinet on how they are going to do this. Post-Budget there would be a multi-year ECC work programme to establish relative priorities between areas of expenditure and reset baselines to reflect this.

Budget 2009

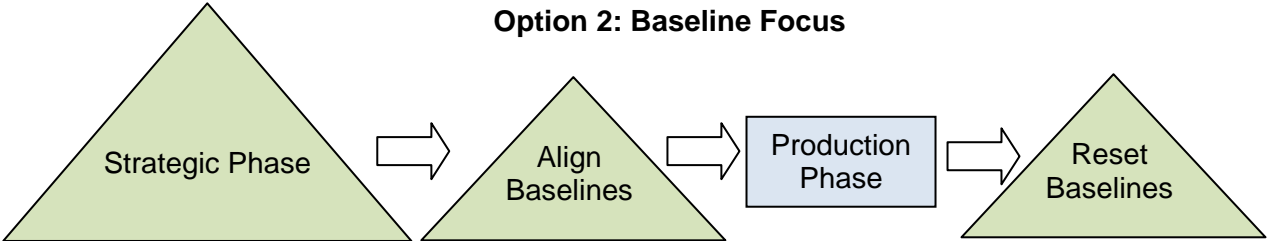


Options for Budget 2010

Option 1: Improved Status Quo



Option 2: Baseline Focus



Recommended Action

We recommend that you:

- a **indicate** in the body of this report your preference for the design of Budget 2010; and
- b **note** that we will further develop your preferred option, and produce a Cabinet paper and supporting Treasury Report by 25 August 2009.

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

Hon Bill English
Minister of Finance

Treasury Report: Budget 2010 Design Options

Purpose of Report

1. The purpose of this report is to guide the discussion you will have on the design of Budget 2010 at Fiscal Issues on Wednesday 19 August.

Introduction

2. The Budget 2009 process review (TR2009/1817 refers) concluded (inter alia) that:
 - Budget 2009 lacked a strong strategic phase and insufficient consideration was given to the detailed shape and structure of the Budget.
 - Previous Budgets have tended to focus on a bidding war around the marginal spend on new initiatives without really examining the existing base of expenditure.
 - The use of bilateral meetings as a decision making medium does not meet the needs of most participants.
 - The articulation of a Budget process, advice of deadlines, and the provision of guidance and instructions all occurred much too late in 2009.
3. These factors have been taken into consideration in the design of both of the proposed Budget processes outlined in this report.

Principles of Budget Design

4. We have developed three principles to guide Budget design:

1. The purpose of the Budget is to match resources to the Government's priorities

2. The Budget must be fiscally sustainable

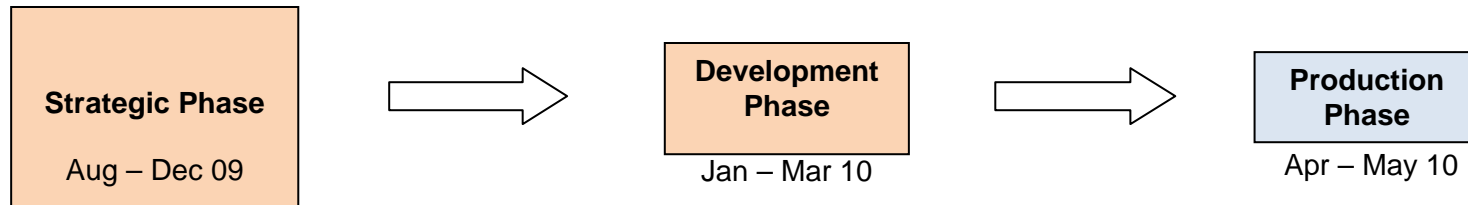
3. The process should assist in creating a positive dynamic between the various players

Common Elements

5. The proposals outlined in this report have the following points of commonality:
 - A ministerial strategy session will be held at Premier House on 12 October 2009 to discuss economic and fiscal strategies, and determine the policy priorities to be focussed on in Budget 2010.
 - The Budget Policy Statement will set out the economic and fiscal strategies, expense cap, priorities and net new spending for Budget 2010.

- Policy bids will only be accepted where they align with specific policy proposals.
- Capital bids will be prepared based on policy priorities and CAM data. Treasury will provide advice on the bids and Budget Ministers will determine which are to be funded from the capital allowance.
- There will not be any bilateral meetings between Vote Ministers and the Minister of Finance.
- The Budget documents production phase is unchanged.

Option 1: Improved Status Quo

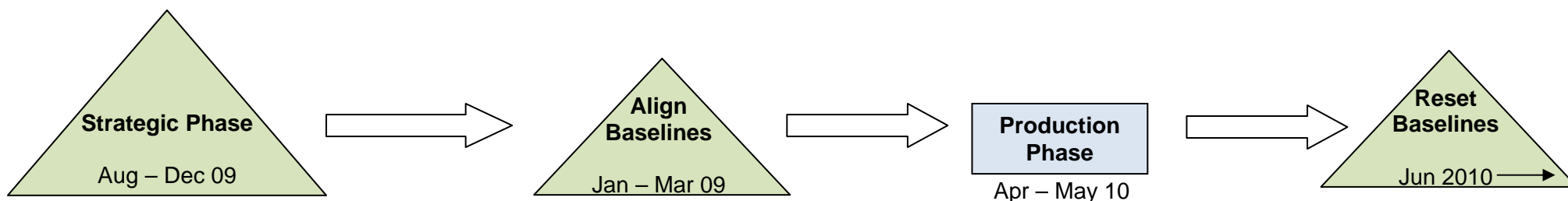


- Categorise agencies into:
 - High scrutiny (for the most risky agencies where there are pressures that cannot be managed within Vote).
 - Self managing (within existing baselines).
 - Self managing – x (within lower baselines).
- The intention is that this aspect of the process be fiscally neutral or release funding for priorities. Allows the allowance to be protected for a few policy priorities.
- Central agencies propose policy priorities [deleted – free and frank].
- Ministerial teams scope up each policy priority and delivery mechanism.

- No bids from departments for bottom up policy proposals or pressures such as remuneration increases.
- Budget Ministers / Cabinet trade-off the options for dealing with high scrutiny agencies against policy priorities to develop a final funding package.

- No substantive change to the process used in previous years.
- Continuing efforts to improve the quality of performance information.

Option 2: Baseline Focus



- Treasury calculates an allocation of the new funding for B10 across all votes. Less than \$1.1 billion may be allocated as some funding could be set aside for capital flow-ons and a between Budget contingency.
- Vote ministers and CE's work together (possibly in sectoral teams) to identify how in their sectors, they could contribute to the direction agreed at Premier House within their baseline and allocation, reporting back to the PM by 30 Nov.
- Decision on fiscal consolidation as to whether savings are to be retained within votes or returned to the centre.
- Any requests for new funding above that already allocated (if approved) reduce the allocation to other ministers.

- Vote Ministers and CE's align baselines to give effect to the proposals made to and agreed by the PM/Budget Ministers, and report back to Budget Ministers / Cabinet.
- Budget Ministers develop an overall package, making cross-cutting tradeoffs as required and integrating fiscal consolidation and other works streams (regulation, tax etc).
- Some savings returned to centre to be retained as a "fighting fund". Noting that this would need to occur within the expense cap.

- As per Option 1.

- Multi-year rolling ECC work programme to establish relative priorities between areas of Government expenditure, based on 3-5 year economic and fiscal agenda.
- Reset baseline based on relative priorities.
- Use reset baselines to establish proportions for the allocation of new funding in future Budgets.

Testing Options against the Principles

1. The purpose of the Budget is to match resources to the Government's priorities

Option 1 – Improved Status Quo

- Clear articulation of priorities through Premier House session.
- Funds released from self-managing- x agencies will be able to be reapplied to priorities.
- Doesn't force agencies to rigorously examine their baselines for alignment with priorities.

Option 2 – Baseline Focus

- Explicitly aligns agency baselines to Government priorities.
- Provides a strong incentive to examine baselines and not focus on marginal spend – in some respects is a move away from fixed nominal baselines, which have encouraged the focus on marginal bids.
- 3-5 year focus, allows ministers to reset baselines over time.
- Somewhat weaker mechanism for making cross-cutting trade-offs – reliant on budget ministers/cabinet, or in some cases ministerial teams.

2. The Budget must be fiscally sustainable

Option 1 – Improved Status Quo

- Provides an effective cap for most agencies.
- Reduces expenditure in non-priority areas.
- Managing high scrutiny agencies will be difficult.
- Allows emergency pressures bids, likely to still be a focus on marginal spend. Restrictive approach to emergency pressures may not be sustainable over time.

Option 2 – Baseline Focus

- Takes cost pressure bids off the table at the outset through provision of new funding allocation.
- Forces agencies to look inside baselines to fund residual pressures and policy priorities.

3. The process should assist in creating a positive dynamic between the various players

Option 1 – Improved Status Quo

- Clear articulation of expectations and priorities at outset.
- No adversarial bilateral phase.
- Provides a mechanism for cross-cutting tradeoffs.
- Intended as a cooperative model, but may ultimately turn adversarial (particularly in high scrutiny agencies).
- Doesn't compel Vote Ministers and CEs to work together to align baselines with priorities.
- Very difficult for Treasury to deliver, information asymmetries with high scrutiny agencies work against achieving desired outcomes.

Option 2 – Baseline Focus

- Clear articulation of expectations and priorities at outset.
- Totally removes focus on marginal spend through up front allocation, allowing focus to be on the base.
- Encourages Ministers and CE's to work together to align baselines.
- Opportunity for Treasury to help rather than black hat.
- More collegial, no adversarial bilateral.
- Provides opportunities for the use of ministerial and/or sectoral teams, and the development of a responsibility model for some votes.
- Zero sum game should result in more effective ownership by Cabinet.

Conclusions

Option 1: Improved Status Quo

6. The *Improved Status Quo* option strongly focuses the Budget on the delivery of key Government priorities, will deliver savings to assist in funding those priorities, and sets up a more collegial process. However, this process would be very difficult to implement as it is reliant on the goodwill and cooperation of agencies. If agencies game the process or adopt a confrontational approach it is likely that the process would be derailed. Additionally, the retention of a facility for departments to submit bids to fund unmanageable emergency pressures means that, to a considerable degree, the focus of the Budget will continue to be on a small amount of relatively insignificant marginal expenditure.

Option 2: Baseline Focus

7. The *Baseline Focus* approach also strongly focuses the Budget on policy priorities. However, through the upfront allocation of the new funding allowance this approach totally removes the focus on marginal expenditure from the process, and forces the focus onto existing baselines. It makes it very clear that the Government's priorities can only be funded if agencies genuinely reconsider what they deliver and how they operate. Also, and perhaps most importantly, the Baseline Focus approach provides a mechanism by which ministers can reset baselines over the next few years so that they are the right size and shape to support the Government's economic and social policy priorities.

Preferred Option

8. Please indicate your preferred option:

- | | |
|--|--------------------------|
| a. Option One - Improved Status Quo | <input type="checkbox"/> |
| b. Option Two – Baseline Focus (<i>Treasury preferred</i>) | <input type="checkbox"/> |
| c. Neither | <input type="checkbox"/> |

Appendix 1: Indicative Process Flowchart – Option 2: Baseline Focus

