

Treasury Report: Vote Education Budget 2010 bilateral

Date:	19 March 2010	Report No:	T2010/434
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Read this briefing prior to the Vote Education bilateral meeting on Thursday 25 March 2010 and refer a copy to the Minister of Education.	Read report by 25 March 2010 Refer a copy to the Minister of Education by 23 March 2010
Associate Minister of Finance (Hon Simon Power)	Read this briefing prior to the Vote Education bilateral meeting on Thursday 25 March 2010.	25 March 2010
Associate Minister of Finance (Hon Steven Joyce)	Read this briefing prior to the Vote Education bilateral meeting on Thursday 25 March 2010.	25 March 2010

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[deleted – privacy]	[deleted – privacy]	[deleted – privacy]	[deleted – privacy]	✓
Stephen Glover	Manager, Children and their Families	917 6123 (wk)	[deleted – privacy]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: No

Treasury Report: Vote Education Budget 2010 bilateral

Purpose of Report

1. You are meeting the Minister of Education at 11.15am on Thursday 25 March 2010 to discuss Budget 2010 for Vote Education (excluding the tertiary sector). The following agenda items have been identified and a separate annotated agenda has been prepared:
 - The Vote Education Baseline Alignment Proposal (BAP)
 - Options for managing operating pressures within the Vote
 - Confirming the treatment of forecast changes
 - A capital allocation for Vote Education

The Vote Education BAP – ongoing funding pressures remain

2. The Vote Education BAP is yet to be submitted (it was due on 8 March 2010). The following comments are based on a draft document supplied by the Ministry of Education. The Vote Education BAP (excluding the tertiary sector) is organised around Government priorities and balances across the forecast period. In addition, there is some acknowledgement of the systemic funding pressures within the sector, particularly within Early Childhood Education (ECE).
3. However, the BAP does not provide a sufficient plan for managing acknowledged cost pressures or provide confidence that policy parameters will allow future Budgets to be manageable without significant service cuts being required:
 - In relation to ECE, some initial savings are provided, but these are unlikely to be sufficient to manage outyear pressures.
 - There are no substantive savings proposed in the schooling sector and no plan advanced for managing foreseeable cost pressures.
 - Within the tertiary sector, significant savings have been found within the Budget 2010 context, and this may limit the ability to make a similar level of savings next year.
4. We believe that the cost pressures facing education require more significant change than that contained within the BAP for the following reasons:
 - Funding pressures will intensify as Vote Education, as proposed by the Minister of Education, starts to manage ECE 'forecast changes' within baselines. In recent years ECE has had forecast changes in excess of \$200 million per annum.
 - There is no guarantee that Vote Education will be provided in future with an allocation of the magnitude provided in Budget 2010.
 - What allocation is provided in the future will need to be prioritised across the education sectors, rather than the situation in Budget 2010 where all new funding

has been allocated to the schooling and ECE sectors. This is particularly likely after the level of savings found within the tertiary sector for Budget 2010.

- Ruling out more incremental change now raises the risk of requiring more dramatic action next year.

Options for managing operating pressures within the Vote

We recommend that you:

a *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

b *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Analysis supporting the recommendations

Early Childhood Education sector

5. The ECE sector creates considerable funding pressures as evidenced by the high level of forecast changes in recent years. While we may be approaching a ceiling effect in relation to ECE centres moving to higher cost funding bands (and the BAP savings proposals help reduce this pressure), overall volumes of hours remain a considerable upside risk which the BAP does not address.
6. We also consider the following factors make it prudent to act now rather than later in relation to managing ECE pressures:
 - The current generosity of ECE subsidy is comparatively recent, but as time passes there will be a greater sense of entitlement.

- *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
 - Funding to ECE has risen dramatically in recent years and represents a significant shift in the boundary of the state consistent with the previous Government's intent. In 2009/10 approximately \$1,120 million will be spent on ECE. In 2004/05 this figure was approximately \$428 million.
7. The major ECE savings element in the BAP involves removing the financial incentive for providers to hire more than 80% registered teachers. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

[deleted – confidentiality of advice]

8. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
9. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
10. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
11. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Confirming the treatment of forecast changes

We recommend that you:

- c **agree** that all forecast changes within Vote Education be made to 'count' against future Budgets, commencing from the 2010 October baseline update

Agree/disagree.

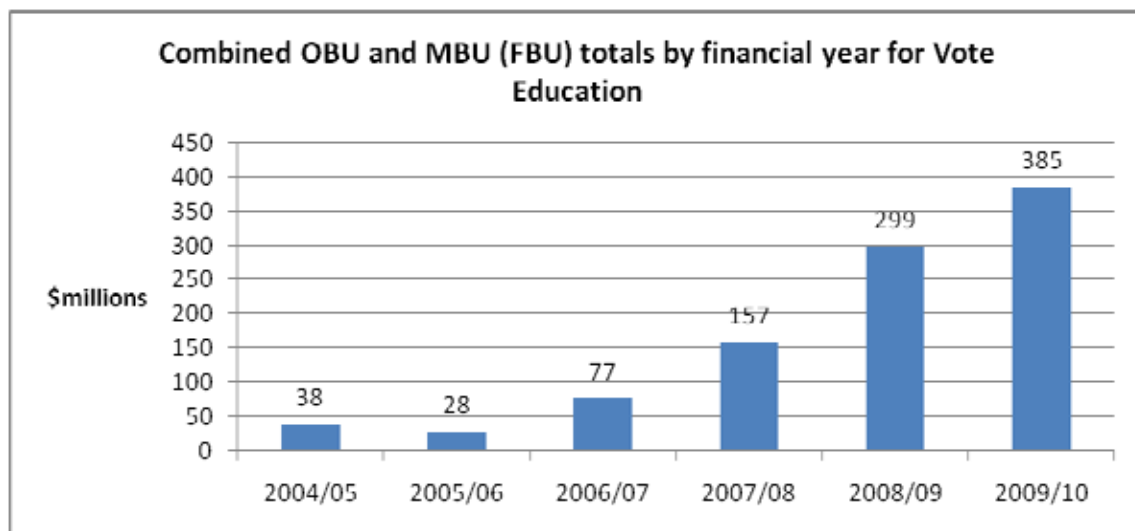
Agree/disagree.

Minister of Finance

Minister of Education

Analysis supporting the recommendations

12. Despite some forecast changes being counted against the Vote Education Budget allocation, the February Baseline Update (FBU) contained an additional \$121 million of forecast changes in the final outyear. \$88 million of this figure relates to the ECE sector.
13. In the absence of a budget constraint there is little incentive for the Ministry to manage the cost growth in the delivery of ECE and schooling sector outputs.
14. The following chart shows the amount of additional funding provided via forecast changes to Vote Education from baseline updates within each of the past six financial years. It should be noted that the final figure of \$385 million was generated despite some forecast changes being managed within the Vote Education Budget allocation in FBU.



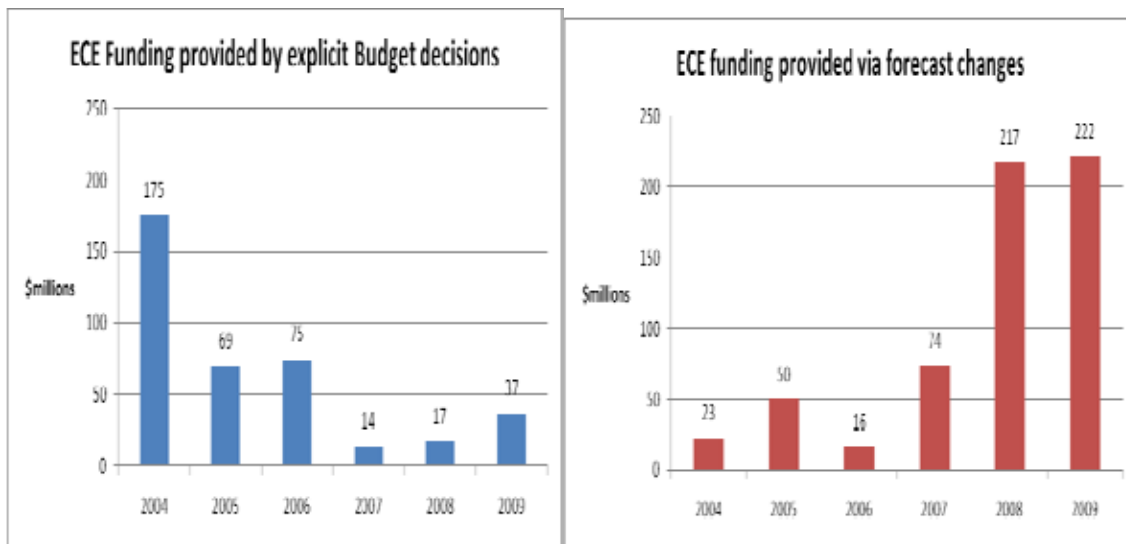
15. The forecast change arrangements are currently in a transitional period. The Minister of Education has proposed that the centre should continue to bear the costs of forecast changes for teacher volumes and changes in school rolls permanently, and for ECE changes until Budget 2011. Other forecast changes were to count against the Vote Education Budget 2010 allocation of \$300 million.
16. Our previous advice (most recently T2009/2489) has noted that there are three key reasons for making Vote Education forecast changes count against the Vote Education allocation:

Incentives – when the centre pays, cost growth continues unchecked

17. Forecast changes are for use in demand driven areas of expenditure where the agency involved for administering expenditure has no (or little) control over increasing or decreasing costs. The argument that education expenditures are demand driven in the schooling sector is undermined by the fact that operational policy decisions determine the cost of providing (compulsory) schooling to additional students.

Transparency – Cabinet should consider funding increases worth hundreds of millions of dollars

18. The level of forecast changes in ECE changes have well exceeded the point where it can be maintained that Cabinet agreed to the scale of funding now baselined within this sector. While Cabinet has explicitly agreed an additional \$387 million baseline for ECE since 2004, an additional \$602 million has been baselined via forecast changes.



Consistency – the onus should be on the Ministry of Education to identify and prove the need for additional funding

19. Providing Vote Education with a budget constraint to manage within would not involve ignoring the cost pressures that exist. However, the onus would be on the Ministry to consider all options to manage or mitigate the increased funding, rather than getting increases as of right.
20. In addition, requiring management of a budget constraint will mean that the Ministry will have a strong incentive to check the accuracy and manage the implications of forecast changes, rather than the Treasury trying to perform these functions from a position of significant information asymmetry.
21. The Treasury recommends that all forecast changes be made to ‘count’ against future budgets, commencing with changes in the 2010 October Baseline Update.

A capital allocation for Vote Education

We recommend that you:

d **agree** to either:

- a. a capital allocation for Vote Education of \$140 million over the forecast period, funded by \$95 million operating to capital swaps from within the Vote Education operating package and \$45 million from the central capital pool (Treasury preferred option);

Agree/disagree.

Agree/disagree.

Minister of Finance

Minister of Education

OR

- b. a capital allocation for Vote Education of \$175 million over the forecast period, funded by \$30 million operating to capital swaps from within the Vote Education operating package and \$145 million from the central capital pool (Ministry preferred option)

Agree/disagree.

Agree/disagree.

Minister of Finance

Minister of Education

- e *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Analysis supporting the recommendations

22. The Treasury recommends that Vote Education be provided a capital budget constraint of \$140 million within which the Minister of Education can advance capital priorities. This approach is consistent with the provision of a \$300 million operating allocation within which the Minister of Education is able to prioritise expenditure. A capital constraint requires consideration of how best to prioritise operating pressures within both the new funding provided and baselined capital funding.
23. The Treasury recommends that the \$140 million budget constraint be funded by a combination of an operating to capital swap from within the Vote Education operating allocation and from a contribution from the central capital pool. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Capital pressures

24. The Ministry of Education is seeking funding to support the following capital projects from Budget 2010. The Treasury's assessment of these projects informs the recommended \$140 million capital allocation.
- *The repair of school buildings with weather-tightness issues.* [deleted – confidentiality of advice]. We believe that given that the true extent of the school weather-tightness issue is not yet known, that only \$82 million (the necessary amount to cover costs of repairs in 2010/11) should be made available. This funding is needed for schools that require immediate repairs in the 2010/11 year.
 - *The new schools capital works programme.* We support the Ministry's minimum proposed level of capital expenditure, which would involve \$40 million of expenditure on the construction of four new schools that cannot be deferred due to demographic pressures. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
 - *IT upgrades to support Budget 2010 ECE savings decisions.* Implementation changes to IT systems that will cost \$2.256 million.
 - *The School Property Management Information System (PMIS) Replacement.* This involves costs of \$7.729 million over the forecast period, and will enable improved asset management of the property portfolio to an advanced Capital Asset Management (CAM) standard and improved information collection.
25. In addition to the capital budget proposals, the national 5 Year Agreement (5YA) spending on the upgrade and maintenance of school property is currently \$32 million overspent with the possibility that this figure could increase to \$50 million by the end of the 2009/10 year. This is primarily due to communications to schools to more actively use their 5YA funding, supporting the government stimulus package and the increased availability of trades people to undertake work. It would be difficult to order schools to slow expenditure (both due to inconsistency with earlier messages, and with the practical difficulties of halting building projects).
26. Vote Communications will seek [deleted – confidentiality of advice] of capital funding in Budget 2010 [EGI Min (10) 3/5 refers] to advance the Broadband in Schools initiative, and if approved, this will be transferred to the Ministry of Education in the 2010/11 financial year. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*. The level of commitment to this expenditure may need to be tested with Ministers in the coming weeks depending on the overall capital position in Budget 2010.
27. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Capital Funding

28. There are three sources of funding which can be used to meet identified pressures:

- Baseline funding that can be reprioritised.
- *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*
- New funding from the centre to support the capital bids.

How to determine the size of the Budget 2010 capital allowance

29. The Treasury considers that \$140 million is sufficient to allow Budget 2010 capital pressures to be managed. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*

The remainder of the proposed \$140 million capital allocation *[deleted – negotiate without prejudice]* can be met with new funding from the centre.

30. As the 5YA overspend involves bringing forward planned work rather than creating new work we consider that the funding gap created should be managed with outyear savings. The proposed \$140 million budget allocation would provide sufficient flexibility to achieve this.

31. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

[deleted – confidentiality of advice]

32. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

33. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Recommended Action

In addition to the recommendations in the body of this report, we recommend that you:

- f. **refer** a copy of this report and the annotated agenda to the Minister of Education by Tuesday 23 March 2010

Yes/No

Stephen Glover
**Manager, Children and their Families
for Secretary to the Treasury**

Hon Bill English
Minister of Finance