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Budget 2012: Four-year Budget Plan

Ministry of Science and Innovation

Covering:

Vote Science and Innovation

Four-year Budget Plan

30 January 2012

Section 1: Overview

Direction of Change

The Government has made substantial investments in science and innovation over the last three years. In 2009, there was an increase in funding for fundamental science. Two thousand and ten saw a boost in funding for research infrastructure, business research and development and the launch of the Technology Development Grants and Technology Transfer Vouchers.

In 2010 the Government endorsed the recommendations of the Crown Research Institute (CRI) Taskforce. The recommendations included defining the core purpose of each CRI, as well as the expected outcomes.

In addition, significant changes in non-departmental output expenses have occurred in the previous two Budgets. These changes include simplification, re-prioritisation and a re-structure of the Vote in 2010 to align with priority outcome areas.

In 2011 the Ministry of Science and Innovation (the Ministry) was created. The new Ministry brings together strategy, policy and investment functions into one organisation to deliver better results. The Ministry is working with CRIs to move them from a traditional purchaser/provider relationship with their customers to one of strategic partnerships. This will require further changes to CRI business models, cultures and practices.

Given that MSI is a relatively new Ministry, it is anticipated that some of the priorities and outcomes outlined in this Budget plan may change over time.

Outcomes and priorities for the next four years

The Ministry is working towards three outcomes: greater prosperity, improved health and well-being, and a healthy environment. The Ministry's work on developing a strategy has identified that the greatest imaginable challenge is to double the value from science and innovation for New Zealand over the next five years. This is not a doubling of the value of inputs, but rather a doubling in the value of the outputs and outcomes attributable to the activity of the science and innovation ecosystem.

To contribute to these outcomes, the Ministry has identified a set of policy priorities. These will predominantly be achieved from within the existing appropriations. The exceptions are the establishment of the Advanced Technology Institute (ATI) and the National Science Challenges, which will be new initiatives requiring new government funding. The estimated operating cost of the ATI is in the order of \$135 million over five years and the capital cost is \$76.1 million. The National Party committed in its manifesto to spending \$60 million over four years on National Science Challenges, which will seek solutions to questions of fundamental importance to our economy, society and environment.

In addition, there may be a need to change the mix of services and outputs that the Ministry produces. The Ministry is currently developing its strategy and intervention logic. The soon-to-be-finalised intervention logic points to a need to focus more strongly on the additionality and the spill-overs generated by our activity. This potentially requires some shift from the provision of grants to loans and services, and facilitation that promote spill-overs that are captured in New Zealand. The Ministry may also need to become a more 'active' manager of its investments.

At this point, the Ministry is still developing its operating model, so the resource implications are not currently known. There are several options for resourcing more intensive contract management and the provision of services. One possibility is shifting resources between

non-Departmental and Departmental appropriations as the Ministry faces make/buy decisions based on best-sourcing principles. Further changes to appropriations may also be required to better align the portfolio with Ministerial/Government priorities.

Efficiency and effectiveness of Non Departmental appropriation

The purpose of the Ministry's non-departmental appropriations is to increase New Zealand's economic, environmental and social performance through science and innovation. The appropriations support a mix of programmes, projects, capability building and infrastructure within research organisations and firms, across a wide range of sectors. The investment spans the entire pipeline from fundamental research through to its application and the creation of high value products and services.

With the non-departmental appropriations set to remain stable over the next four years, the purchasing power of the Vote declines due to inflation. Without nominal increases, over time the Vote purchases slightly less. Some of this cost pressure is potentially put on providers as multi-year contracts are negotiated in nominal terms.

The Ministry's priority is to improve the management, and ultimately the impact, of the Government's investment in science and innovation. The Ministry will develop an investment approach, drawing on asset management tools and concepts, that ensures greater value for money. This will require improvements in portfolio allocation tools, better methodologies for assessing potential return on investment, and improved performance information and active monitoring to manage investments over their life-cycle. Some changes in non-Departmental appropriations will be made within an appropriation and so will not require movement between appropriations.

Efficiencies in Departmental costs

Departmental baseline savings from the amalgamation of the Ministry of Research, Science and Technology and the Foundation for Research, Science and Technology were \$3 million from the 2011/12 financial year and outyears, and an additional \$1 million from the 2012/13 financial year onwards.

In addition, a further \$991,000 efficiency saving is required in 2012/13 onwards. The Ministry of Science and Innovation has identified a suite of initiatives to generate the required savings. Initiatives include reviewing the non-departmental investment models to improve decision making and reduce cost.

The Ministry also intends to review all its purchasing contracts with a view to increasing efficiency and reducing costs. The Ministry will look at ways of building more flexibility into its people cost model in order to more effectively direct effort towards Government priorities. If too much pressure is put on the Departmental appropriation to find efficiencies, there is a risk that the much larger non-Departmental appropriations will not be managed and monitored to maximise both efficiency and effectiveness. Better value for money will require a focus on both efficiency and effectiveness.

From Budget 2012, the Ministry will have a new Policy Advice Output (\$4 million p.a, including overheads) as part of its departmental appropriation. This does not alter the total departmental cost; it simply reflects a new appropriation structure which recognises policy advice as a distinct departmental activity.

Summary of Changes (applies to all agencies and votes)

1.1 Non- Departmental Operating changes sought	Impact \$m increase/(decrease)				
	2011/12	2012/13	2013/14	2014/15	2015/16
Current Baseline	753.967	749.694	753.112	755.712	755.712
Cost pressures resulting from existing policies/settings [section 3]					
Cost of new/increased activities [section 4]		37.000	46.000	46.000	46.000
Efficiency savings [section 4]					
Amount reprioritised [section 4]					
Net impact		37.000	46.000	46.000	46.000
New baseline	768.967	786.694	799.112	801.712	801.712

1.2 Departmental Operating changes sought	Impact \$m increase/(decrease)				
	2011/12	2012/13	2013/14	2014/15	2015/16
Current Baseline	35.422 ¹²	33.892	33.787	33.787	33.787
Cost pressures resulting from existing policies/settings [section 3]		0.341	1.148	1.976	2.826
Cost of new/increased activities [section 4] ³		3.021	3.000	3.000	3.000
Efficiency savings [section 4]		(0.991)	(0.991)	(0.991)	(0.991)
Amount reprioritised [section 4]		(0.341)	(1.148)	(1.976)	(2.826)
Net impact		2.030	2.009	2.009	2.009
New baseline	35.422	35.922	35.796	35.796	35.796

2 Capital investments being considered for new funding in Budget 2012 [section 4]	Impact \$m increase/(decrease)					
	2011/12	2012/13	2013/14	2014/15	2015/16	Out-years
Advanced Technology Institute		11.900	20.000	20.600	23.600	

¹ \$0.9m of this total is for the appropriation Cross Agency Research, which expires on 30 June 2012

² An adjustment to opening baseline funding has been made from 2011/12 onwards, for the reduction in Other Revenue resulting from the reduced contract management fees to be received from MAF for the PGP contracts. This adjustment will be made through MBU 2012.

³ Includes some movement from the Research Infrastructure Contingency for ATI and intervention logic implementation and \$500,000 for administration costs associated with national science challenges

3 Capital investments likely to require new funding in future Budgets [section 4]	Total impact across years \$m increase/(decrease)		
	Budget 2013	Budget 2014	Budget 2015
Advanced Technology Institute	20.000	20.600	23.600

4 Baseline capital expenditure	Impact \$m increase/(decrease)				
	2011/12	2012/13	2013/14	2014/15	2015/16
Departmental					
Baseline funding available for departmental capital expenditure [section 5, table 5, row e]	2.580	2.296	2.296	2.296	2.296
Investments funded from departmental capital expenditure [section 5, table 5, row f]	2.580	2.296	2.296	2.296	2.296
Total [section 5, table 6]		11.900	20.000	20.600	23.600

Section 2: Priorities

The outcomes and priorities for the Vote are set out in the diagram on the following page. The ultimate outcomes that the Vote contributes to are greater prosperity, improved health and well-being, and a healthy environment. This Vote is not the only contributor to those outcomes but there is a set of intermediate outcomes in the science and innovation ecosystem at which the Vote is targeted.

The Ministry's greatest imaginable challenge is to double the value from science and innovation for New Zealand over the next five years. This is not a doubling of the value of inputs, but rather a doubling in the value of the outputs and outcomes attributable to the activity of the science and innovation ecosystem.

The Ministry has identified two broad policy priority areas to effectively contribute to these outcomes. Within each policy priority area, there are a number of specific initiatives which will be pursued. These are:

Policy priority: Supporting the business sector to innovate

New Zealand has a very low level of business expenditure on research and development (BERD), compared to the OECD average. New Zealand's BERD is 0.52% of GDP compared to the OECD average of 1.2% of GDP. BERD is closely linked to productivity improvements and economic growth.

This priority requires focussing effort on incentivising businesses to increase their investment in science and innovation, and improving the supply of business R&D services for the High Value Manufacturing and Services (HVMS) sector through the establishment of an Advanced Technology Institute (ATI).

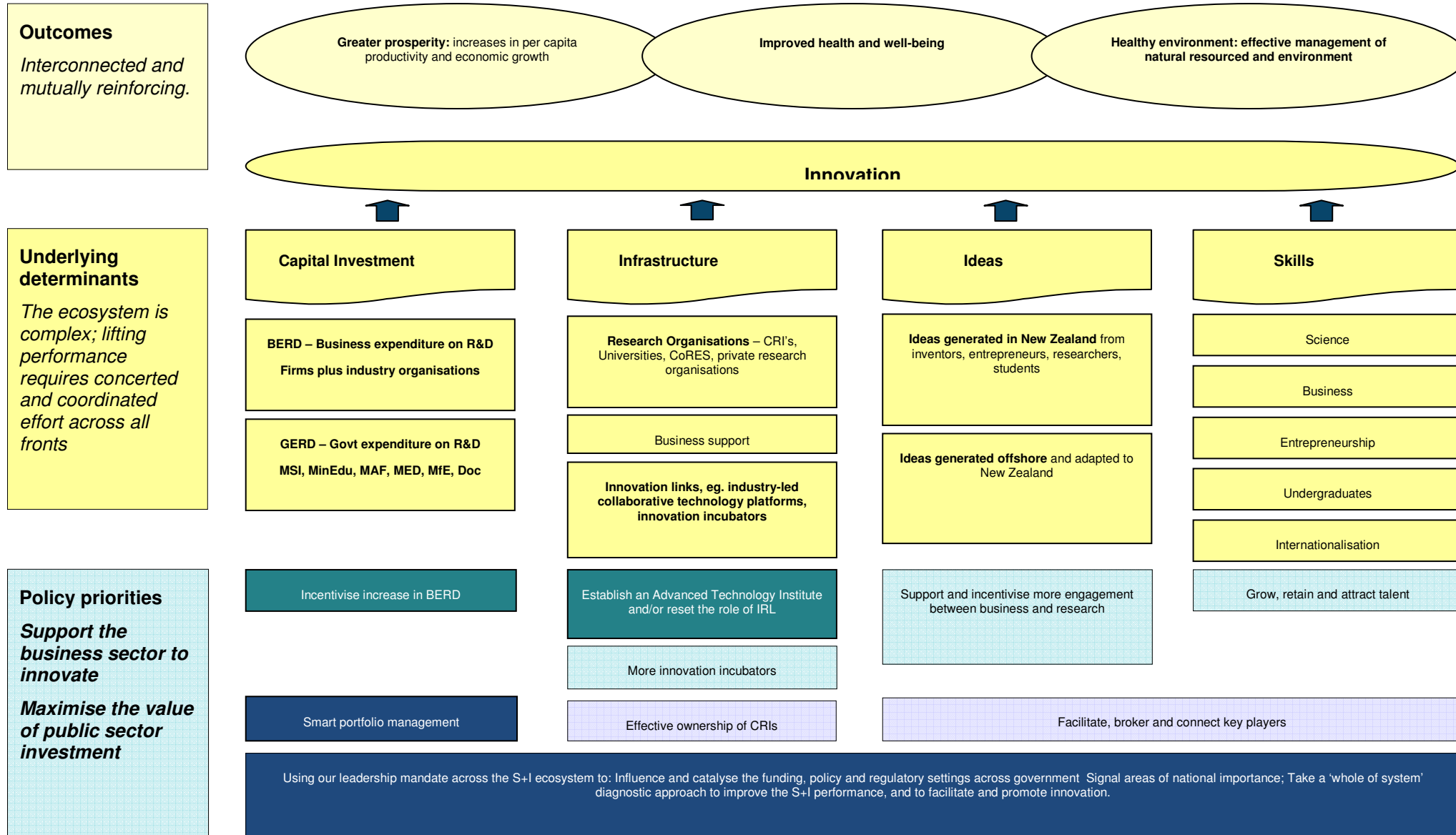
The estimated operating cost for establishing the ATI is in the order of \$135 million over five years. This will be a new initiative requiring new government funding. The funding will not be sought through re-prioritisation.

Policy priority: Maximise the value of public sector investment

The other policy priority is to improve the management, and ultimately the impact, of the Government's investment in science and innovation. The Ministry will develop an investment approach, drawing on asset management tools and concepts, that ensures greater value for money. This will require improvements in portfolio allocation tools, better methodologies for assessing potential return on investment (ex-ante), and improved performance information and monitoring (ex-post) to manage investments over their life-cycle. We will require a greater focus on linking researchers with end users to ensure uptake of the research and alignment of research with end user needs and commercialisation opportunities.

To better articulate the Government's objectives, the Ministry will be developing a Statement of Science Priorities and a Statement of Innovation Priorities in 2012, in conjunction with other agencies. The priority statements will link to measurable economic, environmental and social outcomes. It is expected that some reprioritisation may be required between different appropriations as a result of the priorities statements. Once the priorities are established, officials will undertake in-depth value for money assessments of all activities in the Vote to ensure that the objectives of each appropriation remain valid and that all funding within the appropriation is allocated optimally.

Figure 1 MSI's priority outcomes and strategic policy priorities to drive outcomes



Section 3: Cost Pressures

With the non-departmental appropriations set to remain constant over the next four years, the purchasing power of the Vote declines due to inflation (which includes wage pressures). Without nominal increases, over time, the Vote purchases slightly fewer outputs, all things being equal. The scale of the reduction in outputs is difficult to measure because we don't know the level of price competition in the competitive funding model. Some of the cost pressure is potentially pushed on to providers as multi-year contracts are negotiated in nominal terms. The reduction is spread evenly across the Vote, and has no fiscal or contractual risks. This slight decrease in outputs will be mitigated with an increased focus on the impact and outcomes from MSI's investments in science and innovation, which may include purchasing different outputs over time. The approach to portfolio management is outlined in Section 2.

There are major pressures over the forecast period in the Departmental Appropriation. The merger of the Ministry of Research, Science and Technology and the Foundation for Research, Science and Technology resulted in a reduction in baseline funding for the new Ministry in comparison to its two predecessors of \$3 million for the 2011/12 financial year and outyears and a further \$1 million for the 2012/13 financial year, onwards. This is an effective 10.5% reduction in baseline funding. In addition, the Ministry is required to find a further 3% saving on Crown funding for the 2012/13 financial year onwards.

MSI was created to achieve greater impact than its two predecessor organisations and its role and mandate has increased. Improved investment outcomes require greater monitoring and evaluation of the science and innovation system⁴ and MSI is also now responsible for the CRI ownership and monitoring function. Assuming no efficiency savings initiatives, the Department's cost profile can be summarised as follows:

(\$M)	2011/12	2012/13	2013/14	2014/15	2015/16
Personnel	17.234	17.250	17.698	18.159	18.631
Operating expenses	14.698	15.022	15.382	15.749	16.127
Depreciation/ Capital charge	3.090	3.090	3.090	3.090	3.090
Total	35.022	35.362	36.170	36.998	37.848
Base Line with efficiency savings	35.022	33.552	33.296	33.296	33.296
Savings required	-	1.810	2.874	3.702	4.552

⁴ The Foundation had benchmarked itself against peers and found that it was already more efficient than them in terms of the costs of administering its funds.

Assumptions made in determining the above include:

- no change to current organisational structure and all current Department functions continue
- no staff increases in 2012/13 and CPI of 2.6% pa applied thereafter to salary increases
- CPI of 2.6% pa applied to operating expenses.

Approximately half the Department's costs are Personnel costs. The Ministry is recently formed and approximately half the employees currently employed are new to the organisation. As such salary levels are at market rates. This should reduce the risk of wage pressures in the near future. In addition, the Ministry is looking at building a more flexible employee/contractor cost structure to better respond to current priorities and reduce the wage pressure risk further. Operating expenses include ICT, investment decision making processes, infrastructure costs and specific project related expenditure.

Baseline Departmental revenue includes funding from the following sources:

(\$M)	2011/12	2012/13	2013/14	2014/15	2015/16
Crown Funding	33.673	32.256	32.246	32.246	32.246
Other Revenue					
Contract Management Fees (1)	0.995	1.144	0.900	0.900	0.900
Global Expert Fees	0.150	0.150	0.150	0.150	0.150
SSC reimbursement for SSRSS	0.204	-	-	-	-
Total Baseline Funding (2)	35.022	33.552	33.296	33.296	33.296

(1) Contract Management fees relate to the management of various contracts on behalf of MAF; including Sustainable Land Management Mitigation and Adaptation to Climate Change (SLMACC), and Greenhouse Gas and Primary Growth Partnership (PGP) contracts.

(2) This relates to baseline funding before any Departmental funding to support new initiatives.

It is now expected that the contract management fees to be received from MAF for PGP contract management will be at least \$500,000 less than current baseline in 2011/12, \$650,000 less in 2012/13 and \$500,000 less thereafter. In contract negotiations, MAF are arguing for only paying marginal costs. The marginal cost to MSI of administering these contracts is very low: less than 1FTE. Most of the management fee was attributable to an equitable sharing of the fixed cost of MSI's contract management system. Therefore the loss of the MAF management fee would represent a substantial decrease in income with very little offsetting reduction in cost. When MSI's Crown funding was determined at the time of the merger, it was set based on assumptions about the level of other revenue. The assumptions about the level of PGP contract management fees would be incorrect, if the contract is renegotiated. The re-negotiation outcomes will partly depend on the shape of MAF's

Four Year Budget Plan. If MAF achieves its negotiating aim, in order to maintain the original level of baseline funding, an increase in Crown Funding of \$500,000 from 2012/13 will be required.

Section 4: Proposed Changes for 2012/13 to 2015/16

Efficiency Savings

Departmental efficiency savings work and current status can be summarised as follows:

(\$M)	2012/13	2013/14	2014/15	2015/16
Forecast Appropriation	35.362	36.170	36.998	37.848
Base Line with efficiency savings	33.552	33.296	33.296	33.296
Savings required	1.810	2.874	3.702	4.552
Savings activities				
Already identified	1.810	1.845	1.880	1.916
Target from options for out years		1.029	1.822	2.636
Total savings activities	1.810	2.874	3.702	4.552

MSI only became operational on 1 February 2011 and is still developing its business model, strategy and intervention logic. MSI has already had to find substantial savings. The merger did present opportunities to review purchase arrangements, cost drivers and efficiencies, which have already been included in the current business model.

Additional savings activities identified subsequent to the merger include:

Initiative (\$M)	2012/13	2013/14	2014/15	2015/16	Impact
Reduce ITC support costs through rationalised phone system and virtual server consolidation.	0.345	0.355	0.364	0.373	None
Repay capital and reduce capital charges	0.500	0.500	0.500	0.500	None
Reduce travel costs by better use of technology	0.150	0.154	0.158	0.162	None
Tender purchasing contracts	0.120	0.123	0.126	0.129	None

Initiative (\$M)	2012/13	2013/14	2014/15	2015/16	Impact
Reduce project activities	0.350	0.359	0.369	0.378	Could reduce ability to respond to Minister's priorities/ requirements.
Other minor	0.345	0.354	0.363	0.374	None
Total	1.810	1.845	1.880	1.916	

These savings will ensure the Ministry can operate within baseline for the 2012/13 financial year, assuming the Ministry makes no changes to its operating model, or its outputs.

In order to remain within baselines thereafter, during the first half of the 2012/13 financial year, the Department will determine its preferred actions from the options presented below.

Planned Activities for Out Years

1. Build flexibility into the staffing costs by further varying the level of permanent staff versus fixed-term staff or contractors. This will allow the Ministry to manage the overall cost of people, but will reduce the level of institutional knowledge and the ability to undertake major projects.
2. Complete a review of the potential for shared services with the Health Research Council (HRC) and Royal Society of New Zealand (the Society) who invest funds on behalf of the Ministry. Contracts with the two organisations for the management of investments on behalf of the Ministry total \$3.195 million pa to HRC and \$4.628 million pa to the Royal Society. These contracts are funded through a non-Departmental appropriation, so shared services could result in a transfer from non-Departmental to Departmental appropriations.
3. Complete a review of the potential of sharing some corporate services functions with other government agencies.
4. Review facility requirements with a view to reducing the Ministry's footprint.
5. A value for money assessment of all of the Ministry's functions.

It may be that the savings required will be found from a combination of the above options. If not, the Ministry will complete a review of the "business facing investment" model to reduce the cost of investing. This will include a review of the policy settings.

The Ministry can and must find ways to be more efficient in the way that it delivers its current set of services and outputs. However, there may be a need to change the mix of services and outputs that the Ministry produces. The Ministry is currently developing its strategy and intervention logic. The soon-to-be-finalised intervention logic suggests a need to focus more strongly on the additionality and the spill-overs of our activity. A greater emphasis on spill-overs potentially requires some shift from

grants to loans and services and to facilitation of products that promote spill-overs. As we work through the operational implications of the intervention logic, it is likely that there will be changes in the services that the Ministry delivers.

These may require some shifting of resources between non-Departmental and Departmental appropriations as we face make/buy decisions based on best-sourcing principles.

Risks

The efficiency savings activities and options have risks and possible implementation costs associated with them. These include:

Risk	Likelihood	Impact	Mitigation
1 Jeopardising the Ministry's ability to effectively manage \$740 million of non-Departmental spending and increase the level of economic return on that investment.	Medium	Medium	Management strategies. Implementation of intervention logic and partnership model within the S&I eco-system.
2 Limit monitoring and evaluation of the efficiency and effectiveness of non-Departmental spending.	Medium	High	Management strategies. Implementation of intervention logic. Identify best use of resources between non-departmental and departmental appropriations.
3 A reduction in the Ministry's ability to respond to Ministers	Medium	Medium	Build flexibility into the Departmental cost structure to enable the Ministry to respond to current priorities by stopping other work.
4 Organisational distraction from core business during implementation	Medium	Medium	Strong project management and robust HR and communications plan.
5 Reduced project related funding available to deliver on key outcomes may impact on quality of delivery and ability to respond to unanticipated events.	High	Medium	Build flexibility into the Departmental cost structure to enable the Ministry to respond to current priorities.
6 Loss of key members of staff due to non competitive remuneration.	Medium	Medium	Build flexibility into staffing costs by varying permanent versus contract staff in order to respond if necessary.

[10]

Proposed Change – IODP funding

We seek the appropriation of funding originally intended for the Integrated Ocean Drilling Programme (IODP). The IODP programme was formally withdrawn by the EGI Cabinet Committee in August 2011. The funding for the IODP was part of the Research Infrastructure contingency from Budget 2010, which was provided by restructuring Vote SI funding. The Research Infrastructure contingency was created by reprioritising existing Vote SI funding for specific infrastructure proposals. As the IODP programme is not going ahead, we propose reprioritising the contingency to the highest priority in the Vote (which happens not to be research infrastructure). We are seeking to use the funding of \$1.871 million for 2011/12 to assist with the development and design of the new Advanced Technology Institute. The funding will be appropriated to the Strategic Leadership in the Science and Innovation Sector output class within the Vote SI Departmental MCOA. We are also looking at a fiscally neutral transfer of non-Departmental funding to Departmental funding once the intervention logic work is completed.

The position in the Research Infrastructure contingency is outlined below:

	\$m – increase (decrease)				
	2010/11	2011/12	2012/13	2013/14	2014/15 & outyears
Contingency	7.272	7.682	14.682	14.682	14.682
Transfer agreed <i>EGI Min (10) 30/7</i>	(1.371)	1.371			
Less appropriations already made:					
NeSI (high performance computing)	(5.901)	(7.182)	(7.182)	(7.182)	(7.182)*
KAREN operational support				(4.000)	(4.000)
Balance of Contingency	0	1.871	8.871	3.500	3.500
Less these proposals:					
Australian synchrotron			(7.500)	(1.500)	(1.500)
ATI set-up and establishment costs			(1.871)		
Science and Innovation Contract Implementation of the intervention logic				(2.000)	(2.000)
Balance		1.871	0	0	0

Proposed Change – Advanced Technology Institute (ATI)

Transforming IRL into an Advanced Technology Institute was the highest priority recommendation in the *Powering Innovation* report. The ATI is expected to play a role as a national catalyst delivering technology services to, and building the capabilities of, firms and clusters of firms within the high value manufacturing and services sector, and transferring both knowledge and people from public research institutions into firms. The core functions of the ATI would include:

- supporting growth in high priority sectors
- providing problem solving solutions to individual forms
- supporting underpinning research that meets current and anticipated future business needs
- undertaking training, skills development and technology transfer, transferring knowledge to firms.

The ATI would need to operate with a focus on the bottom line of the sector, not the bottom line of the institute. A full business plan is being scoped. The phasing of the spending is indicative only, but the ATI will be designed to operate within the fiscal envelope set out here.

Proposed Change – National Science Challenges

The National Party committed in its manifesto to spending \$60 million over four years national science challenges. We propose that this be split with \$14.5 million per year for researchers and \$0.5 million per year for administration. The National Science Challenges will seek solutions to questions of fundamental importance to our economy, society and environment.

A pilot NSC has been set up already to reduce agricultural greenhouse gas emissions. Possible other examples are intensifying primary industries in a sustainable way, sustainable energy production, and new high-value foods. National science challenges will encourage collaborations across disciplines and institutions, including universities, public and independent research and development teams, and possibly private sector firms.

Section 5: Baseline capital expenditure

5. Departmental capital expenditure	\$m increase/(decrease)				
	2011/12	2012/13	2013/14	2014/15	2015/16
a. Opening baseline funding available ⁵	0.284	-	-	-	-
b. Depreciation funding (1:51:1, 199)	0.924	0.924	0.924	0.924	0.924
c. Sale of assets (1:52:0, 1999)					
d. Other - Amortisation of Intangible Assets	1.372	1.372	1.372	1.372	1.372
e. Total baseline funding available (a+b+c+d)	2.580	2.296	2.296	2.296	2.296
f. Capital investments funded from baselines	2.580	2.296	2.296	2.296	2.296
g. Closing baseline funding available (e-f)	-	-	-	-	-

6. Non-departmental capital expenditure	\$m increase/(decrease)				
	2011/12	2012/13	2013/14	2014/15	2015/16
Capital investment in organisations other than departments (0:6:X & 0:7:X, 599)		11.900	20.000	20.600	23.600
Baseline funding available for the purchase or development of Crown capital assets (0:6:X & 0:7:X, 699)					
Total		11.900	20.000	20.600	23.600

⁵ For the 2011/12 year, this figure should represent assets held on the balance sheet (e.g. cash and debtor Crown) that are available to fund future purchases of property, plant and equipment. The figure in row (g) for 'closing baseline funding available' becomes the figure in row (a) for 'opening baseline funding available' in the following year.

Section 6: Further options

The appropriations within Vote Science and Innovation are relatively large. MSI has a significant programme of work underway to evaluate and review existing activity within appropriations. For example, in light of recent evaluations of the Tech NZ programmes, MSI is developing policy options for re-designing tools that encourage business R&D. This work is at an early stage; so it is too soon to know if changes can be made within existing appropriations or if they will require changes between appropriations.