

# The Treasury

## Budget 2011 Information Release

### Release Document

June 2011

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- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
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Date: 10 March 2011

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THE TREASURY

Kaitohutohu Kaupapa Rawa

To: Minister of Finance

## **AIDE MEMOIRE: BUDGET 2011 CANTERBURY RECONSTRUCTION FUND**

As requested by your office this aide memoire sets how a Canterbury Reconstruction Fund could be set-up in Budget 2011 and options for funding it within the existing fiscal strategy. It provides our initial thoughts on setting up such a fund and once we have had feedback from you we will provide more detailed advice, including the implications of various options.

We understand the aim of establishing a Canterbury Reconstruction Fund (CRF) is to provide a visible, transparent and flexible way to manage the costs associated with redeveloping Christchurch following the recent Earthquake. Our initial very rough estimate at the Government's obligation for the cost of the Canterbury earthquakes was \$4.5 billion, excluding costs covered by EQC. We are currently working on refining the estimate of these costs.

We recommend a notional fund, rather than physical, to achieve the transparency you are seeking while also allowing flexibility and appropriate control. We see the fund working in a similar way to a tagged contingency, albeit with fuller information and increased transparency.

As the CRF would be a virtual fund, it would not have an appropriation in the Estimates. The main vehicle to communicate the CRF as part of Budget 2011 would be in the Executive Summary where you could set out a clear picture or graph that explains the funding sources and intentions for the CRF.

Calls against the fund would be tracked by Treasury in the following ways:

- Vote Ministers wanting to access the Fund would need to follow the normal Cabinet process to draw from it and establish appropriations;
- approvals made by Secretary of the Treasury for any expenditure incurred using Section 25 of the Public Finance Act;
- decisions made by Chief Executives and Ministers to reprioritise funding within baselines to pay for costs arising from the earthquake would be tracked as they would normally require Cabinet decisions or appropriation adjustments through baseline updates.

We would provide regular updates of actual and expected calls against the fund and the balance of funding available. These could be used to keep your Ministerial colleagues informed and for public communications.

We recommend limiting the fund to the estimate of the cost to the Crown of the earthquakes and topping it up as necessary if the expected cost rises. This is to ensure control and maintain appropriate discipline over spending decisions and to help with communications around managing the costs associated with the earthquakes within your existing fiscal strategy.

## Establishing a Canterbury Reconstruction Fund

Your current plans for Budget 2011 provide you with sufficient funding to establish a CRF within your existing fiscal strategy. See annex 1 for a diagram.

- Our current estimate of savings against the operating allowance in Budget 2011 is \$1.4 billion to \$2.6 billion<sup>1</sup> over the forecast period (based on the PM's Statement to Parliament of an allowance of \$800 to \$900 million).
- The HYEPU forecasts had a capital allowance of \$1.39 billion in each Budget. You are also considering a net zero capital allowance from Budget 2012 to Budget 2014, which would provide \$4.2 billion from future capital allowances that could be redirected to the CRF rather than being used to pay off debt. This option is dependent on managing back forecast capital expenditure and/or finding other sources of balance sheet financing for capital projects.

Funding source	\$ m (operating expenses)				4-yr total
	2011/12	2012/13	2013/14	2014/15	
Operating savings (\$900m allowance)	440	731	679	745	2,595
Capital allowances for Budgets 2012 to 2014	-	1,390	1,390	1,390	4,170
<b>Total</b>	<b>440</b>	<b>2,121</b>	<b>2,069</b>	<b>2,135</b>	<b>6,765</b>

### Options that free up additional funding

If you do not want to use future capital allowances for the CRF, or if the amount set aside is insufficient, you have a number of other options to use as sources of funding. You could:

- decide now to reduce the operating allowances for future Budgets and use the amount deducted for the CRF;
- make further operating cost savings in Budget 2011; or
- implement short-term revenue raising options.

Further information on these options is provided in annex 2.

In addition to new funding, some departments will be able to reprioritise funding (i.e. Education underspends) to cover earthquake costs. Reprioritisation should be included in the fund to give maximum transparency and visibility around decisions and overall costs.

It is unlikely that you will have capacity to use funding from the Budget 2011 capital allowance as it is currently over-committed.<sup>[2]</sup>

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[2]

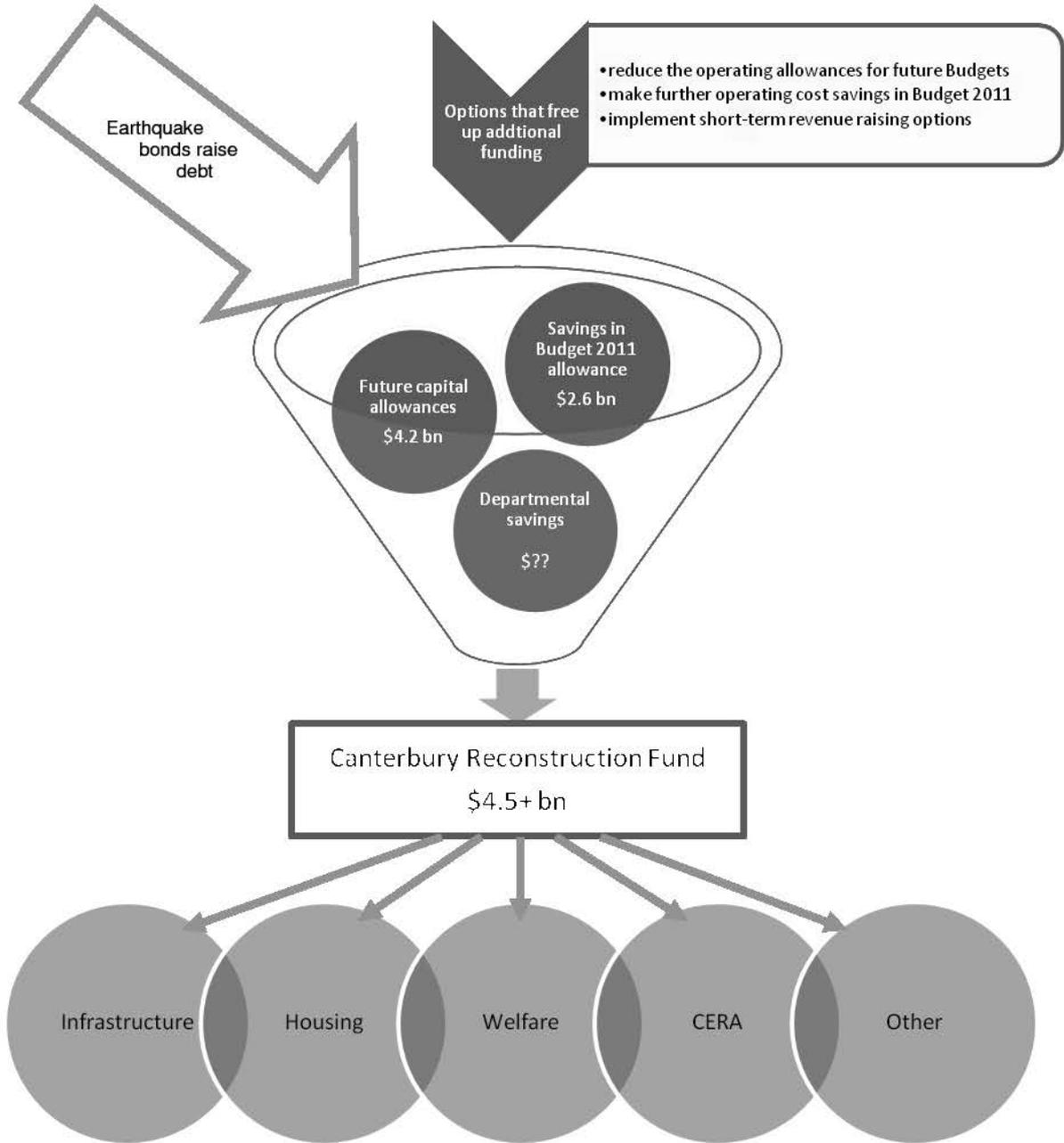
## **Other Options**

Creating Earthquake Bonds would be a way of encouraging investment in Government bonds and providing people with a mechanism to contribute to the reconstruction effort. To adhere to your fiscal strategy, these bonds would be a replacement for other forms of Government debt rather than being a new funding source.

[1]

**Colin Hall**, Manager, Fiscal Management, 917 6227

**ANNEX 1: CANTERBURY RECONSTRUCTION FUND**



## ANNEX 2: FUNDING FROM THE OPERATING ALLOWANCE, REPRIORITISATION AND SAVINGS

### Operating allowance

Based on our understanding of the Budget package spending and savings options that are being considered by Ministers, the Budget 2011 operating allowance will be underspent. Assuming an allowance of \$900 million, there is currently a total of \$2.6 billion available over the forecast period to contribute to the CRF. This amount has been reduced based on Working for Families decisions and will further reduce if Ministers decided not to proceed with other changes to Working for Families and/or KiwiSaver:

*Amount: \$2.6 billion*

Summary of spending and savings	\$ m (operating expenses)				4-yr total
	2011/12	2012/13	2013/14	2014/15	
Total spending	1,341	1,282	1,258	1,261	5,141
less total savings	881	1,113	1,036	1,106	4,136
<b>TOTAL = net fiscal impact</b>	<b>460</b>	<b>169</b>	<b>222</b>	<b>155</b>	<b>1,005</b>
<b>Net operating allowance</b>	<b>900</b>	<b>900</b>	<b>900</b>	<b>900</b>	<b>3,600</b>
<b>Residual remaining for earthquake</b>	<b>440</b>	<b>731</b>	<b>679</b>	<b>745</b>	<b>2,595</b>

### Future capital allowances and proceeds from partial assets sales

The HYEPU fiscal forecasts incorporated a capital allowance of \$1.39 billion for Budgets 2012 to 2014. This allowance could be used as a funding source for the CRF. However, of the \$4.2 billion, only \$1.9 billion capital expenditure is expected to be incurred within the forecast period. Bringing forward spending from outside the forecast period will have a negative impact on the operating balance, through increased finance costs, and increase the borrowing requirements over the forecast period. However, the overall impact on debt is neutral over time.

Budget	\$ m (capital)				4-yr total
	2011/12	2012/13	2013/14	2014/15	
Capital allowance for Budget 2012	-	160	560	300	<b>1,020</b>
Capital allowance for Budget 2013	-	-	160	560	<b>720</b>
Capital allowance for Budget 2014	-	-	-	160	<b>160</b>
<b>Total</b>	<b>-</b>	<b>160</b>	<b>720</b>	<b>1,020</b>	<b>1,900</b>

If future capital allowances are used to fund the CRF, other capital expenditure will need to be funded from the proceeds of the mixed ownership model or other forms of balance sheet funding, i.e. net zero capital allowances from Budget 2012 to 2014.

Given formal decisions on the mixed ownership model have yet to be taken we advise against using this potential policy change as a funding source for the CRF other than as a possible strategy, along with other options, to achieve a net zero capital allowance [3]

*Amount: \$4.2 billion from capital allowances*

### **Future operating allowances**

Current fiscal forecasts assume an operating allowance of \$1.1 billion in future Budgets. To increase the amount of operating expenditure available for the CRF you could reduce future operating allowances and bring the funding forward to pay for one-off costs associated with the earthquake. Reducing the operating allowance to \$900 million from Budget 2012 would allow you to bring forward an additional \$1.2 billion in spending over the forecast period. A reduction to \$800 million would allow you to bring forward \$1.8 billion. This option will heighten the need for expenditure savings in future budgets.

Amount: \$1.2 to \$1.8 billion

### **Further operating expenditure savings**

Any operating expenditure savings identified above those already being considered for Budget 2011 could be allocated to the CRF. However it may not be practical to identify and get agreement to new savings at this point in the Budget process. Decisions could be made during 2011/12 and incorporated into the CRF as decisions are taken. Appropriation changes would be picked up in the Supplementary Estimates.

Amount: unknown

### **Revenue raising initiatives**

If the Government chose to implement any temporary revenue raising initiatives such as a temporary tax levy to fund the cost associated with the earthquake, these could be incorporated into the CRF. Using a levy would allow a fixed amount to be added to CRF.

Amount: depends on decisions taken