The Treasury

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THE TREASURY
Kaitohutohu Kaupapa Rawa

To: Minister of Finance
(Hon Bill English)

Associate Minister of Finance
(Hon Dr Jonathan Coleman)

Associate Minister of Finance
(Hon Steven Joyce)

Aide Memoire: Warm Up New Zealand Extension - Budget 2013 Initiative

The Minister for Energy and Resources has submitted an initiative as part of Budget 2013 to extend the Warm Up New Zealand: Heat Smart (WUNZ) programme by $150m over 2013/14 and 2014/15. This Aide Memoire outlines six options for extending the scheme, and Treasury's advice on the initiative. In summary, our first best advice is to not extend WUNZ. However, we understand that Ministers may wish to extend the scheme. Therefore, we would recommend a $30m one year extension that focuses the programme towards insulating the homes of low income families with children.

This Aide Memoire also outlines options to [6],[7] reduce the current Business Energy Efficiency programmes in order to offset the cost of any WUNZ extension. Business Energy Efficiency programmes total around $25.1m per annum ($12.174m of taxpayer funds and $12.770m funded by the Electricity Levy). We recommend that Ministers cancel the $2.5m a year increase approved in 2012. Should Ministers wish to explore a further reduction or cancellation, agencies will need to do further work on the programmes' wind down or redesign.

Warm Up New Zealand extension

Extension Options

Table 1 outlines six options for extending WUNZ. All extension options target low income households with children as:

- this will help achieve the Government's objective to support vulnerable children; and
- low income groups receive greater benefit from insulation ($758.07 annualised benefit found for CSC holders compared with $239.11 for non CSC holders)[1].

As with the current scheme's subsidy for low income households, this extension will provide a 60% subsidy with the remaining 40% to be paid for by third party charitable funding.

1 Preval, Nick. (October 2012) "An extended analysis of the impacts of retrofitted insulation and new heaters on health services utilisation and costs, and mortality: Evaluation of Warm Up New Zealand: Heat Smart Extension."

It should be noted that the current 2013/14 appropriation for this programme is $11m. Any extension and housing figures below are in addition to this $11m.

Table 1: Summary of options for Warm Up NZ Extension

Options	Option provides	Comment
Option 1 – No extension Treasury first preference	0 – leaving the scheme to end around September 2013 using the current $11m appropriation	Reduces operating allowance pressure. The net benefits of the programme are marginal once the avoidance of premature death (valued at $150,000 pa of benefits) in over 65 year olds with respiratory illness is removed from the calculation. Cabinet has already agreed to exit the scheme through Budget 2012. The scheme is unlikely to have a significant impact on the incidence of Rheumatic Fever.
Option 2 – $30m for one year only Treasury second preference Targeted at low income households with children	13,846 houses in total 1 year extension	Action towards vulnerable children– but unlikely to have a significant impact on the incidence of Rheumatic Fever. Providing funding for 2013/14 only manages fiscal pressures in 2014/15. This option provides a small reduction in the total spent on low income households currently (an average of about $43m pa has been spent over the first three years of the programme on low income houses).
Option 3 – $50m over two years Treasury third preference Targeted at low income households with children	22,700 houses in total 2 year extension	Action towards vulnerable children– but unlikely to have a significant impact on the incidence of Rheumatic Fever. The extension can be phased so that it has a smaller impact in the 2014/15 year. Two year extension unnecessary given that Cabinet already agreed to an exit to the scheme. If regulations are pursued, their development and implementation is likely to take much longer than two years.
Option 4 –$75m over two years Targeted at low income households with children	34,400 houses in total 2 year extension	**Treasury recommends that you do not support options 4- 6** Increases fiscal pressures, including in 2014/15 It is possible that there isn't sufficient demand by the target group to warrant this level of funding. 50% of low income families with children are in rental properties (and therefore we would expect a small uptake from this cohort), and a further 20% are in state housing (and will therefore be insulated under the HNZC scheme).[2]
Option 5 – $100m over two years Targeted at low income households with children	46,150 houses in total 2 year extension	
Option 6 –$150m over two years Targeted at low income households with children	82,500 houses in total 2 year extension	

2 (Perry, B. (2012) Household Incomes in New Zealand: Trends in Indicators of Inequality and Hardship 1982 to 2011. Ministry of Social Development, Wellington)

Treasury Advice

Option 1 No Extension – Treasury Preferred Option

Treasury first best advice is to not approve an extension (option 1) given:

- that this programme does not contribute significantly to the four stated Government Priorities and the Crown is facing other fiscal pressures;
- that Cabinet already agreed to an exit of the scheme for June 2013 with the funding to be spent by September 2013 at Budget 2012 [CBC Min (12) 2/8 refers];
- all of the Government's established insulation goals have been achieved with the current scheme (230,000 houses will be insulated with current funding compared to the 188,500 target established in 2009);
- that 77% of the benefits of the programme accrue to applicants over 65 (who have been previously hospitalised for circulatory illness) through a reduction in premature mortality, valued at $150,000 of benefits to them per year. Once this group is removed from the cost benefit analysis, the ratio is much smaller (approximately to 1.1:1)[3], [6],[7]
- an extension of Warm Up New Zealand is unlikely to have a major impact on rheumatic fever given the indirect route by which uninsulated houses may increase risk of infection. The Ministry of Health's existing rheumatic fever programme or initiatives to increase primary care utilisation among deprived communities would likely influence rheumatic fever rates more directly. There are around 150 new cases of rheumatic fever every year, concentrated in areas of high deprivation in the North Island). Insulation is likely to reduce infections in general, however, the Ministry of Health advises that overcrowding appears to be associated with rheumatic fever more strongly than housing temperature;
- this extension is unlikely to reach low income renters as landlords have been reluctant to take up the scheme to date. Only 14% of the houses insulated under the current scheme were rental properties. EECA and MBIE have indicated that this scheme is unable to be designed to adequately overcome the principle-agent problem in the rental market; and
- that 50% of low income families with children are in rental accommodation and a further 20% are in state housing and will therefore receive insulation through the HNZC insulation programme, only 30% of low income households with children will be in a position where they are likely to utilise an extension.

3 Grimes A, et. al. (October 2011) "Cost Benefit Analysis of the Warm Up New Zealand: Heat Smart programme".

Option 2 - $30m 1 year extension – Treasury Alternative Option

If Ministers wish to extend the programme then Treasury recommends a $30m one year extension (option 2). This option recognises other Crown fiscal pressures and allows the government to focus the scheme towards about households occupied by children.

We are comfortable that this is a viable extension option, despite the lower quantum. This extension isn't significantly lower than the current subsidies provided to low income households. The first three years of the scheme spent on average $43m per annum on low income households. In addition, the fixed costs to run the scheme appear constant from $30m onwards at $3m per annum. Beyond $30m a year, there are additional administration costs incurred as a result of additional advertising, quality assurance services, and additional work to attain third party funding.

Options 3-6 - 2 year extensions

EECA and MBIE have advised that they would prefer a 2 year extension to provide sufficient time for housing insulation regulations to be developed (e.g. mandatory declaration, minimum performance standards, and requirements to insulate all homes) and enable an easier exit for the insulation industry. However, Treasury does not believe there is sufficient justification to prefer a 2 year extension over 1 year, given that:

- EECA were advised to begin signalling the Government's exit to the industry when an extension was granted at Budget 2012. We believe that the industry has had sufficient time to allow for government exit;

- if progressed, regulations are likely to take much longer than two years to develop and implement, therefore subsidising insulation until regulation is implemented is not a sustainable option;

- work on the appropriateness and cost of regulation in this area has yet to be conducted. Until we are clearer about the problem, we cannot be sure that regulating to require insulation in housing is necessary. The use of regulation to improve housing quality could have a negative impact on housing affordability and supply; and

- a two year extension places pressure on operating allowances, especially in the 2014/15 financial year.

If Ministers do prefer a 2 year extension then Treasury would recommend choosing option 3 as it will target households occupied by children at the next least cost option. We would strongly recommend not exceeding $50m over two years due to the Crown's other fiscal pressures (i.e. **we strongly recommend that you do not support options 4-6**).

Business Energy Efficiency savings

Budget Ministers have requested advice relating to the [6],[7] reduction of EECA's current business energy efficiency interventions.

Current programme

The current Business Energy Efficiency programme totals $25.1m pa; $12m from the electricity levy, and $13.1m from general taxpayer funds. This $25.1m includes approximately $4m in EECA fixed overheads. Table 2 outlines the various programmes from both Levy and Taxpayer funding.

Table 2: Current Business Energy Efficiency Programmes

Programme	2012/13 expenditure	Funding Source	
		General Taxation	Electricity Levy
Efficient Lighting product	$4.842m	$0.702m	$4.140m
Commercial building	$10.261m	$5.091m	$5.170m
Industrial (motors and business heat)	$7.177m	$3.717m	$3.460m
Heavy vehicle transport fleets	$1.863m	$1.863m	-
Renewable energy	$0.802m	$0.802m	-
Total	**$24.945m**	**$12.174m**	**$12.770m**

Justification for government intervention

EECA are of the opinion that the national benefit of electricity and oil consumption avoidance warrants the targeted interventions offered. Treasury's view is that the Government only has a role in rectifying failures so that a market economy can maximise welfare. Given that we have a secure energy supply system, an emissions trading scheme, and no capital market failure for domestic lending; some of the current business energy efficiency interventions are likely to be unnecessary, although we note that there may be an ongoing role for information provision.

Options

[6],[7]

Table 3: Summary of options for Business Energy Efficiency

Options	Saving	Implications
Option 1: Cancel the 2012 increase	$2.5m per annum	Minimal operational impact. The Natural Resources BGA stated that the extra $2.5m is expected to save businesses more than $30m in energy costs

[6],[7]

[7] Natural Resources, [7]
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