

The Treasury

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Treasury Report: Budget 2017 Draft Packages and Risks

Date:	6 March 2017	Report No:	T2017/387
		File Number:	BM-2

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Steven Joyce)	Note the contents of this report and discuss with officials at Fiscal Issues on Tuesday 7 March.	Tuesday 7 March
Associate Minister of Finance (Hon Simon Bridges)	Note the contents of this report and discuss with officials at Fiscal Issues on Tuesday 7 March.	Tuesday 7 March
Associate Minister of Finance (Hon Amy Adams)	Note the contents of this report and discuss with officials at Fiscal Issues on Tuesday 7 March.	Tuesday 7 March

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Lachlan Whelan	Senior Analyst, Fiscal and State Sector Management	[39]	N/A (mob) ✓
Kamlesh Patel	Team Leader, Budget Coordination	[39]	N/A (mob)

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any
feedback on
the quality of
the report

Enclosure: [Social Sector Budget 2017 minimum package, 27 February \(Treasury:3673310v1\)](#)
[BGA Budget 2017 minimum package 27 February \(Treasury:3673307v1\)](#)
[Other Budget 2017 minimum package 27 February \(Treasury:3672547v1\)](#)
[Capital Budget 2017 minimum package 27 February \(Treasury:3673309v1\)](#)
[Budget 2017 Risk Register \(Treasury:3669074v2\)](#)

Treasury Report: Budget 2017 Draft Packages and Risks

Executive Summary

Overview

This report provides you with a draft Budget package for consideration. The draft package shows the minimum required to remain within the allowances signalled through the Budget Policy Statement (\$1.5 billion operating and \$3.0 billion capital) and reflects the transition from individual assessment of initiatives by the Treasury to cross sector prioritisation. This includes pre-commitments already agreed by Cabinet.

The draft package is ^[33] **in operating and** ^[33] **in capital.** This does not include Track 1 initiatives and Kaikōura earthquake related initiatives (the largest component of this is reinstatement of the southern corridors). Further advice and recommendations on the Track 1 package will be provided at fiscal issues on 13 March.

The package primarily reflects cost pressures and commitments which are non-discretionary, with very little room for discretionary high value-for-money initiatives. The report draws out the significant trade-offs, risks and implications associated with initiatives that have been significantly scaled back or omitted from the package.

The minimum package provides a good starting point for discussion ahead of the bilaterals with portfolio Ministers around which initiatives are likely to receive funding under affordability constraints. The package is point in time only and we expect it will undergo further refinement and iteration in the lead up to Budget Ministers on Monday 20 March. You may wish to see different Budget package options which allow more high priority initiatives to be funded with a modest increase to allowances.

The report includes A3s attached as annexes for each workstream which provide detail on individual initiatives. As requested by the Minister of Finance, appended to this report also is a risk register which provides an overview of significant areas that will require decisions by Ministers and could potentially impact on the Government's ability to manage Budget initiatives within signalled allowances and meet fiscal objectives.

The key trade-offs and implications associated with the low package for each workstream are summarised below.

Social Sector - ^[33] **per annum (net cost)**

The minimum package for the social sector is quite lean.

- No cost pressure funding has been provided for early childhood education or the schools' operating grant.
- The allocation for health is tight with scaling across DHBs, primary care, disability services and high value-for-money spending in pharmaceuticals.
- Top down adjustments have been applied across justice sector cost pressures, increasing risk and likely adding to future muster pressures.
- Some funding for MVCOT has been deferred, which will increase calls on Budget 2018.

The gross cost of the package is [33] per annum, on average. The net cost is [33] after allowing for the existing MVCOT contingency (\$41.7 million per annum on average) and possible savings from tightening benefit rules for new migrants (\$6.2 million per annum on average). We assume these savings will be used to increase overall headroom.

Business Growth Agenda (BGA) - [33] per annum

The BGA package is primarily driven by three large initiatives: the Housing Infrastructure Fund concessionary charge, Research and Development Growth grants, and NZ Screen Production Grants and totals [33] on average per annum. The minimum package does not allow funding for key priority areas including tourism, research and development, export and trade.

In addition to the minimum package, the Treasury has included a set of initiatives reflecting ministerial priorities as signalled in workstream ministers meetings, and BGA ministers' discussions, totalling an additional [33] per annum. Including these initiatives would bring the BGA package **total to [33] per annum. This would increase the total draft operating package to [33]**

These additional initiatives support the BGA Budget 2017 objective of 'Building a more diversified and resilient New Zealand economy to enable firms to success on the world stage', by investing in key priority areas such as:

- Diversification through international connectedness (Trade Agenda 2030, participating in the Expo 2020 Dubai, and strategic science investment in Antarctica).
- Building a more resilient economy (Regional and social infrastructure, rail, and irrigation).
- Inclusive Growth [33]

Other - [33] per annum

The 'Other' package consists primarily of investment in Defence and Parliamentary Services.

- The Māori Development initiatives were scaled significantly and do not reflect the indication of funding from Budget Ministers of up to \$25 million per annum or the Treasury assessed funding of \$16 million per annum.
- Cost pressures for RealMe (Internal Affairs) have not been included and no funding has been provided for *Preserving the Nation's Memory* (statutory requirement to store documents).

Capital - [33]

The capital allowance is heavily oversubscribed and a number of trade-offs were required to remain within the available allowance for the draft package.

- Defence: The package excludes funding requested for the purchase of [33] This cannot be accommodated within the existing allowance. The draft package reflects funding in full for Defence Estate Regeneration; scaling this to fund only health and safety requirements could be considered.
- KiwiRail: Funding reflects ongoing support of the rail freight business. [34]

Minimum investment will be

required for the upkeep of the lines, however choices remain about the number of years and further investment in rolling stock.

- Reinstating the Southern Corridors: The investment in this initiative (\$1.4 – 2.1 billion) is not accommodated within the draft package. As outlined in the risk register, uncertainty around the cost estimates (for both road and rail) remain. Firmer estimates will be provided in March. Further advice on the potential treatment and impact of this initiative has been provided for Fiscal Issues (T2017/385 refers).

Recommended Action

We recommend that you:

- note** the Treasury has prepared a draft package which allows Ministers to remain within the current allowances settings;
- note** this package reflects top-down adjustments, scaling down and deferral of initiatives which are high value-for-money and therefore involves significant trade-offs;
- note** the package is indicative only and is intended to be a starting point for discussion with portfolio ministers around their key priority areas;
- note** the Treasury has prepared a risk register which sets out significant risks in Budget 2017;
- note** that the risks in the risk register may impact the affordability of the Budget package and the Government's ability to meet its fiscal objectives.

Kamlesh Patel
Team Leader, Budget Coordination

Steven Joyce
Minister of Finance

Hon Simon Bridges
Associate Minister of Finance

Hon Amy Adams
Associate Minister of Finance

Treasury Report: Budget 2017 Draft Packages and Risks

Purpose

1. The purpose of this report is to present a draft Budget package for you to consider. The draft package reflects a minimum amount of funding which allows you stay within operating and capital allowances signalled in the Budget Policy Statement (BPS). This includes precommitments already agreed to by Cabinet.
2. The package provides a starting point for discussion in the lead up to the bilateral discussions with individual portfolio Ministers in the coming weeks and does not represent final advice by the Treasury on a preferred package. Following discussion with officials, the package can be further refined and tested ahead of Budget Ministers on Monday 20 March.
3. The minimum package has not been shared with agency representatives or portfolio Ministers at this stage and is based on the Treasury's assessment of individual initiatives and initial prioritisation across sectors.

Overview of the package

4. The minimum package reflects the following fiscal parameters for each workstream. This is consistent with the operating and capital allowances announced in the BPS.
5. The allocations for each workstream are based on top down adjustments applied by the Treasury and indications from Budget Ministers on how much they would be willing to fund in each of the workstreams. The columns on the right provide a comparison to the allocations for workstream packages in Budget 2016, the key difference being the availability of savings to offset the overall package and the size of the overall capital allowance.

[33]

[33]

Table 2 - Capital allocations by workstream (comparison to Budget 2016)

[33]

6. In Budget 2016, the sectors received the following investment. The information below has been drawn from the Budget 2016 *Summary of Initiatives* document. It excludes tagged contingencies allocated to each sector as this is presented as a separate line item in the document called 'contingencies'. The document also allocates pre-commitments to the respective sectors (which reconciles differences to the totals in Table 1 and 2).

Table 3 – Budget 2016 funding by sector

(\$m)	Average Operating per annum	Total Capital
Social Sector		
Education	179	727
Health	555	-
Social Development	137	12
Social Housing	65	1
Justice Sector	209	-
Total	1,125	740
Business Growth Agenda		
Innovative New Zealand	190	-
Other Business Growth Agenda	140	453
Total	331	453
Other		
Defence & Intelligence	121	1
Māori Development	25	-
Core Government Services	285	512
Other	19	158
Total	449	671

7. Figures 1 and 2 below provide an overview of funding in the minimum package by sector. This is in comparison to the total funding sought by agencies in Budget 2017 and the accumulation of individual initiative assessments completed by the Treasury.

[33]

8. **The initial Treasury Vote Analyst assessment of initiatives provided a good basis for developing the package but required scaling and deferral to prioritise initiatives across sectors.** A combination of factors were considered in the development of the minimum package:
 - a judgements around the value-for-money and alignment of initiatives against Budget priorities
 - b the Treasury's assessment on the level of discretion that exists
 - c analysis on the scalability and timing of initiatives presented as cost pressures, and
 - d existing commitments and legislative obligations.
9. **In order for the package to remain within the allowances, some tough choices were required around scaling significant cost pressures and limiting the number of new and discretionary initiatives that were supported under each workstream.** There are significant implications and risks associated with this (including the risk of creating future funding gaps) which require further analysis and testing with Ministers. These are highlighted in the sections below.
10. The package does not include all fiscal risks that may need to be managed through Budget 2017 and Track 1 initiatives:
 - a Broader fiscal risks are discussed in the body of the report and in the attachment - Budget 2017 Risk Register.
 - b Track 1 initiatives were reviewed by the Social Investment Panel on 27 February – 1 March. We will provide advice on final recommendations for Track 1 and how to manage any fiscal implications in the week of 13 March.

Social Sector Workstream

Highlights

11. The draft social sector package includes funding for education, health, social development, the justice sector, and MVCOT/Oranga Tamariki. No new funding is recommended for ACC. There are no social housing bids in Track 2.
12. **Overall, the Treasury's gross Social Sector minimum package stands at an average of [33].** This compares to total bids from relevant agencies of [33]. Preliminary VA recommendations totalled [33] per annum, although there have been some new/revised bids since these were made.
13. **The net social sector minimum package stands at [33] per annum** after allowing for the unused Budget 2016 MVCOT contingency (\$41.7 million per annum on average) and savings from tightening benefit rules for new migrants (\$6.2 million per annum on average). We assume these savings will be returned to the centre and used to increase total headroom within the operating allowance.
14. The minimum package comprises cost pressure funding of [33] per annum, with funding for new initiatives of [33] and capex-related operating costs of [33]. There is some scope to push these numbers down further at the margins, however the trade-offs will become harder. Some additional costs are likely to materialise between now and Budget: this includes a [33]

15. Detailed commentary for individual sectors is provided below.

Education

16. **Minimum package:** [33] **per annum.** [33]
17. Material cost pressures are evident across the system, including in departmental capacity, as the Ministry aims to deliver an ambitious reform programme and manage demand growth. Forecast changes (9538 and 9539) are the biggest component, and non-discretionary under current policy settings.
18. We have suggested some funding for departmental cost pressures (9547 and 9549), in view of current capacity constraints. However, as the Ministry has yet to develop a clear operating model for its future role, we suggest scaled and time-limited funding at this time. We have not included funding for the schools operating grant (9532) or early childhood education (9531), with some risk of a negative impact on services.
19. We have scaled the Ministry [33] and ICT initiative (9550) to the minimum needed to maintain systems, although more funding might deliver better value (greater flexibility, lower support costs in future). Some initiatives that would help to lift achievement if funded have been excluded or scaled down. These include the [33] and curriculum resource support for Maori-medium education (9534). No funding is included for schools' payroll sustainability (9546).
20. Hon Parata is likely to press for more funding for: early childhood education (9531); the schools operating grant (9532); [33]

Health

21. **Minimum package:** [33] **per annum.** This does not include funding for Terranova, with incremental costs (the agreed fiscal envelope) already in the forecasts and business-as-usual wage growth to be managed within baselines and normal budget funding increases (although see comment below).
22. Health has a fixed nominal baseline and faces a range of cost pressures. It has bids for [33] in cost pressure funding. We have scaled this back to [33]. The biggest item is DHB funding (9780), which we have held at [33]. The other significant items are disability support services (9781) and primary care (9738), both of which we have scaled quite hard (possibly a bit too hard). We do have some concerns about the Ministry's ability to manage the business-as-usual cost growth component of the Terranova settlement. We have not recommended funding for [33] at this time as the proposal is not sufficiently developed.
23. [33]
24. [33]

25. We have scaled down the electives bid (9733): this was overfunded last year, with the Ministry now rolling money forward due to capacity constraints. For the maternity services bid (9743), we recommend holding funds in a tagged contingency pending the outcome of the current arbitration process. [33]

26. For bowel screening (9735), we suggest funding the first two tranches (5 DHBs), with a tagged contingency for tranche 2. [33]

There are risks to viability of joint procurement of IT system (with the bowel screening programme) and timing for implementation (including some workforce risk).

27. We suggest scaling down funding for organ donation (9754) and water fluoridation (9755), to focus on areas where it is clear what is proposed and why. [33]

Social Development

28. **Minimum package:** [33] **per annum.** [381]
[33]

Other pressures include security guard presence; and IT, telephone and property lease costs, which we generally recommend funding.

29. We have scaled back the new initiatives quite hard. Low value initiatives are excluded (including some that are important to Ministers). We have also excluded some discretionary items that we would recommend funding if headroom allows. Points to note:

a Gang action plan community-based pilots (9662). The project has good momentum and early evaluation findings are promising. It is a low cost option to mitigate an expensive part of the welfare liability. [33]

b [33]

c [33]

d [33]

30. **Minimum package:** [33] **per annum.** The story here is all about cost pressures, driven partly by increased serious crime (category 3) volumes, which have impacts for courts, prisons, and probation services. It is not clear whether this trend is driven by increased crime or more aggressive charging decisions by the police. Decisions last year on family violence and police numbers also contribute to the forecast increases. The big ticket items are as follows:
- a Courts: managing serious crime driven volumes and related pressures (9499). Includes legal aid, court ordered costs, coronial services and related departmental pressures. The minimum package strips out cost pressures for district courts, although this could impact negatively on the remand system and access to justice (through longer times to process hearings and trials).
 - b Corrections: managing increased prisoner volumes (9673). This bid has increased since initial VA assessments. Volumes are higher than initially expected. Staffing to cover additional prisoners is the major cost driver, with limited scope to do things differently under existing collective agreements. There is some scope to reduce costs by deciding not to fund an increase in related service (rehabilitation programmes, drug dogs, special response teams). In the absence of scaling options from agency, we have imposed a top down haircut of 15%, as a proxy for this. There would be trade-offs in terms of staff, prisoner safety and rehabilitation outcomes.
 - c Corrections: Auckland East (9898). Seeks shortfall funding for efficiencies not achieved because of higher than expected prisoner volumes (so it is effectively an additional bid for muster pressures). [33]
 - d Corrections: prisoner pipeline impact on probation (9675). This is a flow-on effect of prisoner volumes. There is more short-term flexibility here in terms of how much funding is provided, [33]

MVCOT / Oranga Tamariki

31. **Minimum package:** [33] **per annum.** This assumes unused Budget 2016 contingency (an average of \$41.7 million per annum) is returned to the centre. The minimum package represents the least we think could be provided while still meeting legislative and other commitments. It defers as much as possible to Budget 2018 and sets time limits to funding for status-quo services that could be impacted by future changes. This simply shifts some funding pressures out one year, as is also the case in other sectors. [33]

32. There are two significant cost pressure bids:
- a Business as usual pressure (no. 9710). This includes wage pressures, along with demand growth for out-of-home placements; the minimum package includes funding for these. The bid also seeks funding for Family Start, to move from 53% to 100% of home visiting staff being qualified and compensate for price inflation. There is a good evidence base to support investment in Family Start; but it is discretionary, so we have excluded it from the minimum package.

b Raising the age of care and protection (no. 9699). [34]

33. [33]

34. We recommend one-year funding to keep existing children's teams operating (no. 9702) pending a review of the scheme. [33]

Accident Compensation Corporation

35. **No funding recommended.** ACC is seeking additional funding for the non-earners account. Our view is that the scheme is adequately funded so we have not included new budget funding in the package. The bid excludes funding for Terranova: ACC may request this in due course (as reflected in the HYEPU forecasts).

Business Growth Agenda Workstream

36. **Overall, the Treasury's minimum BGA package stands at an average of** [33] **per annum.** This package is driven by three large initiatives (Housing Infrastructure Fund no. 9712, NZ screen production grants no. 9587 and R&D growth grants no 9568), as reflected in the annex. The funding profile for the minimum package reduces in outyears to [33] Remaining in the operating allowance would mean no additional, high value-for-money initiatives could be funded.

37. In addition to the minimum package, we have included a set of initiatives reflecting ministerial priorities as signalled in workstream ministers meetings, and BGA ministers' discussions. The additional investment would total on an average [33] of operating per annum. Including these initiatives would bring the BGA package **total to** [33] **per annum.**

38. The intention, as agreed by the BGA ministers and Leadership Group, is for BGA Budget 2017 to be based around the theme of 'Building a more diversified and resilient New Zealand economy to enable firms to success on the world stage'.

39. The current major investment areas in support of moving towards the BGA vision are:

Diversification through international connectedness:

- Trade Agenda 2030 including new posts in Colombo and Dublin, and investment in resources for MFAT and MPI to maximise benefits from trade and strengthen our resilience.
- Diversifying the export base, and drive higher value by participation and leveraging opportunities with Expo 2020 Dubai.
- Science and innovation investment in a globally integrated innovation network, new business through innovation, and adaptive regulatory frameworks and competitive markets.

- Addressing pressures associated with the New Zealand Screen Production Grant.

Building a More Resilient Economy:

- Investments in strengthening the management and development of urban infrastructure especially housing, and regional infrastructure through rail and irrigation support.
- Building tourism infrastructure through the tourism infrastructure fund, and the tourism growth initiative.
- Realising the full potential of our marine resources in a sustainable and innovative way.

Inclusive Growth:

- [33]

-

40. These emerging investment areas require significant prioritisation and scaling of initiatives across the BGA. Areas which are currently not included are investment in the tertiary sector, climate change and the marine strategy, which we understand Ministers are planning to have further conversations on.

41. The additional investment in priority areas totals [33] operating per annum, bringing the **total investment, including the minimum package, to [33] per annum.**

Table 4 - Initiatives reflecting ministerial priorities on top of the minimal package

Initiative		Per year (\$m)	Link to BGA theme
Tourism Infrastructure	Tourism infrastructure fund	[33]	Diversify the export base and drive higher value
	Tourism Growth Initiative	[33]	
Trade Agenda 2030	Making New Zealanders more prosperous	[33]	Secure access to diverse markets
	Making New Zealanders safer	1.676	Protect our people, reputation and investment

	Establishment of a New Zealand High Commission in Colombo, Sri Lanka	2.216	Diversify the export base and drive for higher value
	Establishment of a New Zealand Embassy in Dublin, Ireland	2.283	
	Maximise trade agreement benefits and accelerating value growth in primary sector exports	[33]	
	Creating Economic Opportunity: A Treasury Presence Offshore (Singapore)	0.854	
Export Markets Other	Dubai 2020	13.310	
Innovation	Endeavour Fund	20.479	New business through innovation. You indicated this would be your top priority for investment in science and innovation in addition to the demand pressures for the R&D growth grants. This is a scaled option.
Infrastructure	Three Waters	[33]	Other infrastructure, including social and regional infrastructure
Natural resources	Future of our Fisheries	7.620	New Zealand realises the full potential of its marine resources in a sustainable and innovative way
	Grant funding to support regional irrigation scheme development	6.666	Thriving communities care for and get what they need from their freshwater
	Battle for our Birds 2017	5.329	The value of biodiversity to the economy and the lives of New Zealanders is reflected in our natural resource decisions
	[33]		

Safe and skilled workplaces	[33]		
Antarctica	Our place in Antarctica – Development of a detailed design, business case and delivery strategy for the future replacement	0.535	Globally integrated innovation network
	Accommodation support for national Antarctic programmes with operations based out of Christchurch	0.863	
	Strategic science investment fund: Antarctic science platform	7.000	
Investment	Multinational Corporation R&D Attraction Programme	[33]	Ensuring access to good quality financial advice
	Improving Financial Capability in New Zealand	2.540	
TOTAL		[33]	

Other Workstream

43. The draft “other” package includes funding for Arts, Culture and Heritage, Defence, Finance, Internal Affairs, Māori Development, Parliamentary Services and a mix of smaller portfolios.
44. **Overall, the Treasury’s minimum “Other” package stands at an average of [33] per annum.** This compares to total bids from relevant agencies of [33] Preliminary VA recommendations totalled [33] per annum, although there have been some new / revised bids since these were made.
45. The minimum package is comprised from predominantly, investment in Defence [33] per annum) and Parliamentary Services (\$11 million per annum). We have scaled back the remaining package quite hard. The balance of the package is made up of scaled non-discretionary initiatives that fund statutory requirements and a smaller investment in Māori Development (than previous Budgets). If the Defence numbers are pushed down further, the Treasury would recommend that this funding is directed to higher value-for-money initiatives which were excluded due to the size of the package.
46. Detailed commentary for individual sectors is provided below.

Defence

47. **Minimum package:** [33] per annum. The majority of this funding [33] per annum) reflects the Government’s commitment to the Defence White Paper (DWP) and direction by Budget Ministers that this would be supported. The DWP commits the Government to an indicative funding track and decisions are taken on specific initiatives; decisions to defer expenditure could be explored, which may free up further room for other initiatives.

48. [33]

a [33]

b

Māori Development

49. **Minimum package:** [33] **per annum.** This compares to [33] totalling [33] per annum [of these were incomplete and so could not be assessed).

Preliminary VA recommendations totalled [33] per annum. The low amount of funding in the draft package reflects that these initiatives are largely discretionary and could be more easily scaled to remain within the allowances; it does not reflect the potential strategic alignment and value-for-money if considered on an initiative-by-initiative basis.

50. The Treasury has provided its preliminary assessment of these initiatives (T2017/495 refers). Though these assessments will move around, the Treasury would recommend that this area is funded as a priority, up to the level of [33] per annum. Investment in Māori Development (and Treaty Negotiations below) should be considered in the wider context of the impact on the Māori economy and regional economic development.

51. Key initiatives within Māori Development include:

a [33]

b [33]

c The Māori Housing Network (initiative title: "Supporting better housing for whanau in need") (no. 9859) targets whanau in severe housing deprivation and makes a tangible difference to their living conditions (and therefore health). It is not replicated anywhere else in government funding. Critically though, we need to see an evaluation of the programme to be confident it is offering the highest value for money possible, and recommend that any funding is contingent on an evaluation taking place.

Parliamentary Services

52. **Minimum package: \$11 million per annum.** The majority of this funding relates to a mix of non-discretionary initiatives for demand driven services, implementing select committee recommendations and wage settlements. There may be some scope to push these numbers down further or defer initiatives at the margins, however the trade-offs will become harder.
53. This package excludes the Parliamentary Accommodation ^[33]
Cabinet agreed to a preferred option to pursue for costing and invited the speaker to submit a Budget initiative (CAB-16-MIN-0586). Not funding may have operating funding implications (for a new lease premises) and may limit options.

Remaining portfolios (Arts, Culture and Heritage, Finance, Internal Affairs, Pacific Peoples, Revenue, ^[33]

54. **Minimum package:** ^[33] **per annum.** This funding has been limited to non-discretionary initiatives, predominantly where not funding would risk not fulfilling statutory requirements or may lead to service failure. The following areas do present risks due to the initiatives included in the draft package:
- a Internal Affairs: Excludes funding for RealMe (where cost recovery has not offset the cost), support for the Local Government Commission (statutory requirement on levels of service) and defers *Preserving the Nation's Memory* ^[33] for meeting statutory requirements to store documents.
 - b ^[33]
 - c ^[38]

Capital Workstream

55. The draft capital package includes significant funding for BGA Infrastructure, Defence and requested investment for health and education. The initiative (no. 9791) *Reinstatement of the Southern Corridor* is currently reflected in the draft package and VA assessment; including this initiative will exceed the capital allowance in Budget 2017. Further advice on earthquake initiatives has been provided (2017/385 refers).
56. **Overall, the Treasury's minimum Capital package stands at a total of** ^[33] **(excluding initiative no. 9791).** This assumes a fiscally neutral treatment of around ^[33] which would impact on net debt (over the period to 2020/21) over and above the capital allowance as outlined below. Including the lower bound of the *Reinstatement of the Southern Corridor* (no. 9191) estimate would bring the draft package to a total of ^[33] This compares to total bids from relevant agencies of ^[33] (including no. 9791). Preliminary VA recommendations totalled ^[33] (including no. 9791).

57. Including pre-commitments, the overall package is heavily weighted towards investment Corrections [33], Defence [33], with limited investment in Health [33] and Education [33]. The Investment Panel and the Treasury will prepare further packages for Investment Ministers on Monday 13 March, which may investigate a more balanced selection of initiatives.
58. Detailed commentary for individual sectors is provided below.

Net Debt Impact of Fiscally Neutral Initiatives

59. Two initiatives are proposed to be funded in a manner that is considered fiscally neutral under the Fiscal Management Approach (repaid within a ten year period). However, these will have an impact on net debt as the Crown must borrow in the interim which hits the fiscal indicators.
60. There are options to limit the amount of impact these have on the net debt indicator and these are outlined briefly below.

- a **Auckland Housing Programme:** [33] The Treasury has provided separate advice on alternative mechanisms for offsetting this request (T2017/315 refers).
- b **Auckland Vacant or Underutilised Crown Land:** Funds the purchase of land for housing development and is offset by the proceeds. During the interim, there is an impact on net debt. This initiative could be scaled down to approximately the lowest value plot of land [33] with a commensurate decrease in the number of plots purchased and housings built.

Defence (excluding pre-commitments)

61. **Minimum package:** [33] The majority of this funding reflects the Government's commitment to the DWP (ANZAC Frigates Communications Upgrade and Littoral Operations Support Capability) \$302 million and the first tranche of the Defence Estate Regeneration programme [33]. [33]

2. [33]

63.

64.

Education

65. **Minimum package:** [33] The scaled funding in the draft package reflects funding for roll growth classrooms, land already purchased and one school in Pukekohe. [33]
The Treasury will provide further options on the make-up and choices available to Ministers, as requested on Friday 3 March.
66. Funding minimum roll growth only, without any new schools or expansions, may require increased used of enrolment zones and is less effective at meeting and managing network demand. Expansions are an efficient way to add capacity.
67. [33]
68. There is some risk around deferring the relocation and rebuild of the Manurewa kura and wharekura onto Ministry-owned sites, as they are currently operating in buildings with condition issues that make remediation poor value for money, and experiencing roll growth due to the high proportion of Māori students in the wider Manurewa and Manukau areas.
69. The Treasury is currently undertaking analysis of the Ministry of Education's MBU submission, which similar to MBU 2016, transfers funding from delayed capital projects into future years.

KiwiRail Investment

70. [33]
71. [33]
72. KiwiRail has prepared alternative scaled options to those presented in the business case, which include an assessment of the associated impact on the network. KiwiRail presented these alternatives to the Treasury on Tuesday, 28 February. This will be reflected in the updated assessment for Investment Ministers on Monday 13 March for the Treasury package and Investment Panel package.

[37]

- 73.

BGA – Export and Natural Resources

74. **Export: Minimum package:** [33] This reflects investment in two new overseas locations (Dublin, Ireland and Colombo, Sri Lanka), which are discretionary, and a small investment in the Department of Conservation (DoC) to support tourism [33]
The low funding for the tourism initiative would likely have implications on DoC's baseline. Funding of up to \$13 million is required for increased costs to support existing services. Scaling and deferral options exist for the expanding products and the extent to which this component is investment ready.
75. **Natural Resources: Minimum package:** [33] This reflects funding for Crown Irrigation (CIIL) to invest in schemes likely to be agreed in the 2017/18 year and supports regional development. CIIL has \$42 million on its balance sheet which can offset, and this could cover investment in the two smaller schemes. The risk of not provisioning for these schemes is that a pre-commitment on Budget 2018 would need to be made; the partners for these schemes are currently raising capital and consents have been granted. The funding is expected to be repaid to the Crown within 15 years of investment; the Treasury will consider the effect of these potential offsets.

Remaining Portfolios [33]

Health, Social Development).

76. [33]

77. **Social Development: Minimum package:** [33] This primarily supports ICT investment for the department (no. 9654) and availability for frontline services (no. 9656). [33]

78. **Health: Minimum package: \$150 million.** Provides funding for the DHB Capital Investment Pool for 2017/18 (no. 9789). The Treasury is still engaging with the Ministry of Health to determine the capital needs and remaining funds available.

Fiscal Risks

79. As requested by the Minister of Finance, the attachment – *Budget 2017 Risk Register* provides a register of the fiscal risks that likely need to be managed in the near term through Budget 2017. The purpose of the risk register is to identify and track significant areas that will require decisions by Ministers which could potentially impact on the Government's ability to manage Budget initiatives within signalled allowances and meet fiscal objectives.
80. Presenting the register alongside the minimum package provides a full picture of the potential commitments that the Government may need to manage within any fiscal headroom available. The Treasury will continue to update this register throughout the decision-making process.
81. As the fiscal risks are decision focussed, it does not capture forecast risks such as the impact from changes to the economic outlook, asset and liability valuation changes caused by external factors and SOE results. A fuller picture of forecast changes will be reported after the preliminary fiscal forecasts are completed on 23 March.

82. The risks are classified into three categories (outlined below) and includes information on the nature of the fiscal risk and estimated size, point of further advice and timing of risk and the level of choice and discretion available to Ministers.
 - a Impact on allowances.
 - b Choices around allowance impact.
 - c Outside of allowances and impact on indicators.
83. Although some of the risks identified have been picked up in the minimum package presented above (for example, sector cost pressures), there are still several risks that require decisions from Ministers on treatment against allowances and impact on fiscal indicators (if they arise).
84. This register may overlap with, but does not replace existing tools, such as the Crown Asset and Liability Management Framework, nor the Specific Fiscal Risks (SFRs) chapter of the Economic and Fiscal Updates. The purpose of SFRs is to capture significant risks to the Crown's forecasts over the medium term, with some risks being quite broad in nature.
85. The key risks the Treasury has identified are reflected in detail in the annex. Non-discretionary initiatives mainly reflect announcements and commitments made by the Government to date (e.g. Housing Infrastructure Fund, Terranova) or Permanent Legislative Authorities (e.g. funding shortfalls for the Earthquake Commission).
86. Discretionary initiatives mainly reflect large Budget initiatives, for which some choices remain and may dictate the impact these have in Budget 2017. These choices and trade-offs have been reflected through the minimum package.

Next Steps

87. You are having **bilateral meetings** with portfolio ministers in the coming weeks and you may wish to circulate this package (or a version of it) to support these discussions. The current package reflects the bare minimum amount that could be funded under the current capital and operating allowances, and can be a good base to have a conversation with portfolio ministers around key priorities, choices and trade-offs required.
88. The next **Budget Ministers** meeting is on Monday 20 March. The minimum package can be further refined and tested in the lead up to this meeting. Alternatively, the Treasury can present options around a slightly higher package which requires a modest increase to allowances (\$1.7 billion operating and \$4.0 billion capital).
89. Advice from the **capital and social investment** will be provided this week. This will provide an additional layer of expertise and ensure that the initiatives are subject to further scrutiny. The Treasury will report back on the discussions and outcomes from the panel at Investment Ministers and Fiscal Issues on 13 March and 14 March respectively. Advice from the panel will also be reflected in future iterations of the package.
90. The Treasury will provide a report on Fiscal Strategy advice in light of preliminary BEFU forecasts on Friday 31 March, to inform discussion at **Budget Ministers** on 3 April.

Budget 2017 Risk Register

Purpose and Scope: The Budget 2017 risk register identifies significant areas that will require decisions by Ministers which could potentially impact on the Government's ability to manage Budget initiatives within signalled allowances and meet fiscal objectives.

Risk	Description	Estimated Size	Further advice and information	Level of discretion
		Impact on allowances		
City Rail Link	The Government has committed to fund 50% of the costs associated with the City Rail Link project, which is estimated to cost \$3.4 billion. Based on this estimate, the Government's contribution to the project will be around \$1.7 billion. There is a risk that the timing and amount of government contribution towards the project could be different from what is included in the forecasts.	\$1.7 billion based on a total cost of \$3.4 billion. Budget Initiative submitted for current estimated cost.	Advice will be provided to Ministers in late March (BM #3) and costs are expected to be confirmed in April. An independent QA of the costs is going to be undertaken (due P50 - P90 costings).	Non discretionary Manage through capital allowance. Government commitment to fund 50% of costs of the CRL has been announced publicly. Costs are assumed to be managed over the next 4 Budgets.
[38]				
Housing Infrastructure Fund	As final proposals are not expected to be received until late March 2017, and as decisions are still yet to be made about the water infrastructure governance and loan arrangements, there is a high level of uncertainty in the areas noted below, which may have additional fiscal impacts that need to be managed: <ul style="list-style-type: none"> The split between capital and operating spending, which will impact fiscal indicators. Currently the fund has been reflected as capital expenditure in the forecasts. Whether or not market interest rates will be applied to the loans. Whether or not the full amount of the fund will be repaid to the Crown. For the amount that is repaid, when the repayment will occur. 	Up to \$1 billion impact - at HYEPU treated as fiscally neutral for allowances purposes, as funds were assumed to be repaid within 10 years. Assuming a loan is provided to councils, a Budget Initiative has been submitted for the concessionary charge amount only (\$331.5 million in 2017/18).	[33] Submissions from councils will be received on 31 March and Ministers will be updated in April. Final funding decisions will not occur until around June 2017.	Non-discretionary \$1 billion fund to support councils has been announced publicly by the Government and included in HYEPU forecasts. Choices exist around form of assistance provided to councils and timing of repayment.
New Zealand Screen Production Grant	The New Zealand Screen Production Grant – International is an uncapped, non-discretionary grant and must be supported unless there is a policy change. The initiative is for \$240 million and covers known and anticipated calls on the appropriation for the two remaining years of the multi-year appropriation.	\$240 million over two years.	Bilateral meeting with Minister Bridges in week of 27 February. Discussion of pressures and Budget package development: Budget Ministers #2, 20 March.	Non-discretionary Manage within operating allowance. Some discretion may exist if policy settings are changed.
Auckland Housing Programme	Housing New Zealand requires further capital to deliver on the Auckland Housing Programme. There are options around how this funding can be provided to the company to achieve maximum return and encourage innovative practices.	[33] Vote team and Commercial Operations to provide advice on this risk.	Housing team to provide further advice to Ministers on financing options for HNZA. The Minister responsible for HNZA and the Minister of Finance are meeting to discuss the initiative on Monday 20 March.	Discretionary Options around form and scale of assistance provided to HNZA. Repayable loan will have impact on net debt.
Justice - Prison Musters and other cost pressures	The Corrections prison musters continue to realise upside risks. The recent decision on police numbers has a consequential impact on capacity required [33]. The latest Corrections muster forecasts indicate further emergency accommodation is required [37]. The Ministry of Justice is also seeking significant funding to meet demand-driven cost pressures and new initiatives across Justice and Courts.	[33] \$125 million average per annum (operating).	Justice Sector Leadership Board to report back to Ministers by March. Corrections will report back on options regarding the need for additional capacity in March. Budget initiative(s) to be updated to reflect the increases. Discussion of pressures and Budget package development: Budget Ministers #2, 20 March.	Discretionary Manage through capital and operating allowance. Choices exist around scale and timing of funding required.
KiwiRail	[33] Treasury and the Ministry of Transport are working with KiwiRail to assess the business case and funding options (including scalability and period of funding), following which further advice will be provided to shareholding Ministers and the Minister of Transport on the initiative.	[33] Budget initiative of [33] has been submitted by the Ministry of Transport.	The Treasury has requested KiwiRail to submit alternatives that require a lower level of capital, or are over a shorter time period (or both), for Ministers to consider. The Treasury has engaged G Dangerfield (former CEO NZTA) and W Peet (former CEO ONTRACK) and in conjunction with the Ministry of Transport will provide advice on the range of alternatives provided by KiwiRail.	Discretionary Manage through capital allowance. Choices exist around scale and timing of funding required.
Education	Significant funding sought through Budget 2017, which is a mix of ECE forecast changes resulting from population growth, cost pressures and new initiatives.	[33] average per annum (operating). [33] capital impact.	Next Budget Bilateral with Minister Parata: 15 March. Discussion of pressures and Budget package development: Budget Ministers #2, 20 March.	Discretionary Manage through operating and capital allowances. Choices exist around scale and timing of funding required.
Health	Significant funding sought through Budget 2017, which is a mix of cost pressures and new initiatives. Main cost driver is additional support for DHBs.	[33] average per annum (operating). [33] capital.	Discussion of pressures and Budget package development: Budget Ministers #2, 20 March.	Discretionary Manage through operating and capital allowances. Choices exist around scale and timing of funding required.
Defence	Significant funding sought through Budget 2017, primarily relating to implementation of the Defence White Paper 2016. [33] A breakdown of Defence initiatives was provided in T2017/43.	[33] impact on capital allowance [33] over the forecast period. [33] operating over the forecast period.	[33] Treasury will identify scaling options and their implications as part of package development for Budget Ministers. Budget bilateral recommended if significant scaling foreseen.	Discretionary Manage through operating and capital allowances. Choices exist around scale and timing of funding required.
Innovation Funding	Significant funding sought in the Business Growth Agenda work stream through Budget 2017. This funding is a mix of cost pressures and new initiatives split between four areas: Antarctica NZ, Public Sector Innovation, statistics and Science and innovation.	[33] impact per annum sought over forecast period.	Budget Bilateral scheduled with Hon Goldsmith on 8 March. Discussion of pressures and Budget package development: Budget Ministers #2, 20 March.	Discretionary Manage through operating allowance. Choices exist around scale and timing of funding.
Ministry for Vulnerable Children, Oranga Tamariki	Significant funding sought through Budget 2017, which is a mix of cost pressures and new initiatives. Likely will use an existing contingency agreed in Budget 2016 to offset cost of supported initiatives. Funding through future Budgets will likely tie funding to proving effectiveness of the current baseline.	[33] impact per annum over the forecast period.	Next Budget Bilateral with the Minister for Vulnerable Children is 21 March. Discussion of pressures and Budget package development: Budget Ministers #2, 20 March.	Discretionary Manage through operating allowance. Choices exist around scale and timing of funding.

Risk	Description	Estimated Size	Further advice and information	Level of discretion	Contact
Earthquake Commission (Crown guarantee)	EQC's forecast cash deficiency takes into account EQC's current assets, assumptions around the Canterbury tail, a payment to LINZ for insured residential red zone land claims, an 85th percentile estimate of Kaikōura claims and a number of other assumptions. There is uncertainty and risk (both upside and downside) around the timing and scale of these cost components for the 2017 calendar year.	[33] EQC's current highest forecast). The HYEFU forecast included a call on the Crown guarantee of \$685m.	EQC will be providing Treasury with updated cash deficiency forecasts in March 2017 and Treasury will then provide an update on the expected cash deficiency and the Crown Guarantee financing requirement. T2017/385 seeks confirmation of the Budget treatment of the EQC guarantee.	Non-discretionary Permanent Legislative Authority	[23]
Other earthquake related initiatives	Significant uncertainty exists on the estimates related to the damage to 3 Waters infrastructure sustained in the Kaikōura earthquake and the associated impact of the Crown (assumed a 60/40 split) for Kaikōura, Hurunui and Marlborough District Councils.	Unknown at this stage.	For the Crown's 60% share: • We expect the majority of any funding to be provided through a Permanent Legislative Authority (PLA) and therefore it does not impact the Budget 2017 operating allowance. This was agreed by Ministers in T2017/385. • Any costs related to betterment, rather than like-for-like asset replacement, would need to be considered on a case-by-case basis as to whether they can be considered within the scope of the PLA. If not, these would impact on the Budget 2017 operating allowance.	Non-discretionary Permanent Legislative Authority Discretionary Annual appropriation	
Southern Transport Corridor reinstatement	As with other earthquake items, uncertainty around the cost estimates (for both road and rail) remain. Firmer estimates will be provided in March. Two main risks are: • The timing of the confirmed amount. • Lowering the amount (expectations have been set based on the December announcement). [33]	\$1.4 – 2.1 billion impact. <i>Budget initiative submitted for estimated rebuild cost (\$1.4-2.1billion).</i>	• The Ministry of Transport will report back to Cabinet in March on the funding mechanisms and fiscal implications. • T2017/385 seeks a decision on the Budget treatment of this initiative. [33]	Non-discretionary Government commitment to rebuild Southern Transport Corridor has been announced publicly	
Outside allowances and impact on indicators					
Southern Response	Southern Response will seek additional funding via an on-call capital facility based on the actuary's report to the Board on 24 February. [34], [37] Currently the capital forecast exceeds the current uncalled capital facility by \$126 million. [37] Capital subscriptions have an impact on the core Crown net debt; however as Southern Response is part of the Crown, there would be no impact on the total Crown operating balance. Consistent with the treatment in previous years, there is no impact on the between-Budget contingencies or Budget allocation, as this is a valuation change relating to an existing liability.	Up to [37] impact.	• SRES board meeting Friday 24 February. • Update to Ministers on Tuesday 28 February.	Non-discretionary Impact on net debt, valuation change. Some discretion exists around size of capital facility provided.	
TerraNova	The cost of the settlement (minus BAU wage growth) was included in the HYEFU forecasts. Expectation is that this cost will be managed outside the allowance. MOH has made a settlement offer within the agreed fiscal envelope (\$1.88bn over 5 years), but expects the unions to make a counter-offer with a 5-year of \$2.0bn+. There are likely to be at least some additional flow-on costs for MSD. Dealing with private costs for aged care residents would also increase costs. Decisions will be needed in due course about how to appropriate funding for Health and ACC.	Fiscal envelope is \$1.879b over five years (including ACC costs). Does not include private aged care costs (\$215m over 5 years), MSD costs (unknown).	MOH has made a settlement offer within the agreed fiscal envelope. A counter-offer from the unions is expected in week beginning 20 March. This is likely to outside the fiscal envelope (\$2.0bn+). In that case, Ministers will need to decide how they wish to respond.	Non-discretionary if settlement is reached. Fiscal envelope costs already included in HYEFU forecasts.	
Tax and Transfer Package	A potential package of tax and transfer options to be considered as part of Budget 2017.	[33]	Next meeting with Ministers has not been scheduled. We anticipate that decisions could be taken at Budget Ministers on either 3 or 10 April.	Discretionary Package based on Ministerial preference and headroom available in BEFU forecasts.	