The Treasury

Budget 2017 Information Release

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[36]	to maintain legal professional privilege	9(2)(h)
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[39]	to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)
[40]	Not in scope	

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Office of the Minister of Finance

Chair
Cabinet

BUDGET 2017

Proposal

1. This paper seeks approval of the Budget 2017 package.

Executive Summary

2. At a time when many parts of the world face significant political and economic risks, the outlook for New Zealand is positive. Growth continues to be supported by high levels of construction activity, exports (particularly tourism), inward migration, and low interest rates.

3. Stronger economic growth is flowing through to the Government's books. Forecasts show an improvement in economic and tax forecasts from the Half Year Update. Alongside a steady expenditure profile, this means that the Government is on track to meet its fiscal target of reducing net debt to around 20 percent by 2020. This has been a key anchor underpinning decisions in Budget 2017.

4. Investment in Budget 2017 supports the following key priorities:
   - Delivering better public services for a growing country, using a social investment approach.
   - Investing in infrastructure to support a growing economy.
   - Supporting families to get ahead through the Family Incomes package.
   - Reducing net debt to around 20 percent of GDP by 2020 then to 10 to 15 percent of GDP by the middle of the next decade.

5. The overall package reflects investment in infrastructure and services for a growing economy, meets critical demand pressures first, provides some funding for new high value investments, and supports vulnerable populations through the social investment approach.

6. It also responds to the Kaikōura earthquakes. In the last six months, the Government has provided financial assistance, temporary accommodation and psychosocial support services to those who need it. Budget 2017 provides

significant capital investment to support the big task ahead to restore full access on SH1 before Christmas 2017.

7. In the Budget Policy Statement last year, we agreed to set aside an operating allowance of $1.5 billion per annum for operating and $3.0 billion for capital [CAB-16-MIN-0638 refers]. Funding sought through Budget 2017 significantly exceeded those allowances.

8. To help meet this challenge and respond to the Kaikōura earthquakes, I am proposing to increase both the operating allowance to $1.8 billion and the capital allowance to $4.0 billion. This will allow for more balanced investment in Budget 2017 in the key priority areas mentioned above to support our growing economy.

9. In order to delivering public services and infrastructure for a growing economy, new investment provided through the operating and capital packages is outlined in Table 1 and 2:

Table 1: New operating spending, savings and revenue in Budget 2017

	$ million increase / (decrease)						
	2016/17	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**Total**	**Average**
New spending	125.4	1,627.1	1,900.6	1,866.9	1,954.5	7,474.5	1,868.6
Savings/revenue	(8.1)	(1.7)	(54.8)	(106.8)	(107.5)	(278.8)	(69.7)
Net spending	**117.3**	**1,625.5**	**1,845.8**	**1,760.1**	**1,847.0**	**7,195.7**	**1,798.9**

Table 2: New capital spending, savings and revenue in Budget 2017

	$ million increase / (decrease)						
	2016/17	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**Outyears**	**Total**
New spending	396.3	1,337.0	1,309.4	734.9	206.3	30.7	4,014.1
Savings/revenue	(6.9)	(10.8)	-	(19.7)	(0.2)	-	(37.6)
Net spending	**389.4**	**1,325.7**	**1,309.4**	**715.3**	**206.1**	**30.7**	**3,976.5**

10. The revenue measures included in the Budget 2017 operating package relate to Base Erosion and Profit Shifting (BEPS) tax reforms. The first BEPS measure restricts the ability of New Zealand businesses to use double deductions of foreign hybrid entities to reduce their tax liabilities in New Zealand. The second BEPS measure confirms the progression of other BEPS proposals subject to modification in consultation. Overall, this raises revenue of $50 million in 2018/19 and $100 million in later years.

11. The Budget also provides for a significant Family Incomes package. The package will:

- provide more rewards for hard work by lowering the effective marginal tax rates for low and middle income earners to help them get ahead;
- start simplifying the tax and transfer system so incomes are more clearly linked to people's effort;
- help lower income families with young children meet their living costs, and
- improve incomes for those with high housing costs.

Economic and Fiscal Conditions

The economy is expected to continue to expand

12. The economic outlook for New Zealand is more positive than in the Half Year Update, although the profile of growth has shifted to peak later in the forecast period (Table 3).[1] Near term momentum in the economy is a little weaker than previously anticipated. Nonetheless, migration inflows, construction activity (including rebuild activity related to the Kaikoura earthquake), exports (particularly tourism) and low interest rates are expected to underpin above-trend growth of around 3-3½% over the year ahead. Growth is expected to peak at 3.8% in early 2019, as residential investment growth resumes after reaching a temporary plateau in 2017 (owing to tighter credit conditions and more binding capacity pressures than previously thought) and as the stimulatory impact of the Family Incomes package flows through the economy.

13. While the growth outlook in New Zealand's key trading partners remains broadly similar to the HYEFU forecast, international uncertainties have increased. Growth has slowed in Australia but this has been offset by faster growth in other advanced economies, notably in the US. Risks remain around future US economic, trade and fiscal policy, the continued imbalances in the Chinese economy and political developments in Europe, including the details of Brexit and various elections. The extent of the potential impacts from these uncertainties and the precise channels through which they might impact on New Zealand are difficult to ascertain.

14. Consumer price inflation is expected to pick up over the forecast period as spare capacity is used up, stabilising at an annual rate of 2% in mid-2019, a little later than forecast in the Half Year Update. Inflation is expected to be volatile over the year ahead as a number of temporary factors such as recent petrol and food price rises drop out of the annual calculation.

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1 Note the final economic forecasts are due to be completed on 18 April and tax forecasts on 21 April. The numbers referenced here are provisional and still subject to change (in particular the economic impact of the Family Incomes package)

15. The Family Incomes package is expected to increase GDP over the last three years of the forecast period, primarily through the household consumption channel. There will be some offsets to GDP from higher imports (related to consumption) and weaker investment growth (due to higher interest rates, with an earlier monetary policy response than otherwise). The impact of the Family Incomes package is to increase nominal GDP by around $3 billion cumulatively compared to a pre-Family Incomes package forecast.

16. Higher levels of economic activity (supported by higher population growth), the Family Incomes package, and higher terms of trade support nominal GDP, which is cumulatively $24 billion higher than in the Half Year Update across the five years to June 2021. Some of this increase reflects historical revisions to GDP; allowing for this the net change compared to the Half Year Update is closer to $17 billion.

17. Tax revenue is expected to be marginally lower than in the Half Year Update. This comes from a combination of the increase to tax revenue from higher nominal GDP and the reduced revenue owing to the Family Incomes package.

Table 3: Near final economic forecasts

June years		**2016 Actual**	**2017 Forecast**	**2018 Forecast**	**2019 Forecast**	**2020 Forecast**	**2021 Forecast**	**5-year totals Gross**	**Net**
Economic growth[1]	HYEFU16	2.8	3.6	3.5	2.9	2.4	2.3		
	BEFU17	**2.7 (R)**	**3.1**	**3.5**	**3.8**	**2.9**	**2.4**		
Unemployment rate[2]	HYEFU16	5.0	4.8	4.6	4.2	4.3	4.3		
	BEFU17	**5.0**	**5.0**	**5.0**	**4.6**	**4.3**	**4.3**		
CPI inflation[3]	HYEFU16	0.4	1.5	2.0	2.1	2.0	2.1		
	BEFU17	**0.4**	**1.8**	**1.6**	**2.1**	**2.2**	**2.1**		
Current account balance[4]	HYEFU16	-2.9	-3.0	-3.8	-4.1	-4.4	-4.4		
	BEFU17	**-2.9 (R)**	**-2.8**	**-3.0**	**-3.3**	**-3.7**	**-3.9**		
Nominal GDP[5]	HYEFU16	4.2	5.2	5.6	5.0	4.1	3.9		
	BEFU17	**4.2 (R)**	**6.2**	**4.8**	**5.4**	**5.0**	**4.2**		
Nominal GDP ($billions)	HYEFU16	251.8	264.8	279.5	293.4	305.5	317.4		
	BEFU17	**253.1 (R)**	**268.9**	**281.8**	**297.0**	**311.9**	**324.9**		
	change	1.3	4.1	2.3	3.6	6.4	7.5	23.9	17.4

R - revised 1. Production GDP, annual average % change 2. June quarter 3. Annual % change 4. Annual as % of GDP
5. Expenditure measure

Note: the figures in this table are based on near-final economic forecasts and are subject to change.

18. The Government is on target to meet its fiscal objectives, operating surpluses are steadily growing and net debt is on a downward trajectory: net debt is forecast to be around 20 percent of GDP by 2020 and well within the range of 0 to 20 percent beyond the forecast period.

19. Overall, the preliminary fiscal forecasts show a stronger outlook than expected at the Half Year Update. The operating balance before gains and losses (OBEGAL) is forecast to rise strongly from 2016/17 with surpluses reaching $10.0 billion (over 3 percent of GDP) by the end of the forecast period.

20. Core crown expenses as a share of GDP are on a downward trajectory. The preliminary forecast, before new expenditure agreed at Budget 2017, shows that core Crown expense fall from approximately 29 percent of GDP in 2015/16 to just over 27.0 percent of GDP by the end of the forecast period.

21. Forecasts show net debt has peaked and is now on a downward trajectory.

22. The stronger outlook for tax revenue (prior to the impact of the Family Incomes package) compared to the Half Year Update has provided some headroom to increase allowances and implement a Family Incomes Package.

23. Budget 2017 provides for an increase in operating and capital allowances focussed on investing in public services in a growing economy and addressing the implications of the Kaikōura earthquake. Budget 2017 also announces a Family Incomes Package of around $2.3 billion per annum effective from 1 April 2018onwards, aimed at boosting the after tax incomes of low and middle income households and providing greater work incentives by adjusting the bottom two tax thresholds.

24. The operating allowance for Budget 2018 is now $1.7 billion (an increase of $200 million), rising by 2 percent each Budget thereafter. The capital allowance for Budget 2018 remains unchanged at $2 billion and then increases to $2.5 billion from Budget 2019 onwards.

25. Incorporating the above decisions and other known adjustments to the preliminary fiscal forecasts is likely to result in net debt being around 20 percent of GDP by 2020/21 and OBEGAL surpluses rising.

26. The final fiscal forecasts for the Budget Economic and Fiscal Update are due to be completed on 3 May. The table below provides an indication of key indicators. The numbers are provisional and are subject to change.

Table 4: Indicative BEFU 2017 – Key Fiscal Indicators

	Actual			**Forecast**		
$ billion, June years	**2015/16**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**
OBEGAL - 2017 Est BEFU		**1.8**	**3.0**	**3.7**	**5.5**	**7.1**
OBEGAL - 2016 HYEFU	1.8	0.5	3.3	5.4	6.8	8.5
Residual Cash - 2017 Est BEFU		**(0.3)**	**(1.8)**	**(1.6)**	**0.9**	**1.4**
Residual Cash - 2016 HYEFU	(1.3)	(2.2)	(2.1)	1.4	3.0	2.6
% of GDP, June years						
Net Debt - 2017 Est BEFU		**23.3**	**22.9**	**22.2**	**20.9**	**19.6**
Net Debt - 2016 HYEFU	24.5	24.3	23.8	22.2	20.3	18.8

The Government's Fiscal Priorities

27. The Government has built up fiscal credibility on the back of a strong record in meeting its fiscal targets. The OBEGAL surplus was achieved in 2014/15 and it

is appropriate that the focus now shifts to managing our debt level in order to build resilience for future shocks.

28. The Government's shorter-term fiscal priorities have been to:

- Maintain rising OBEGAL surpluses over the forecast period so that cash surpluses are generated and net debt begins to reduce in dollar terms.
- Reduce net debt to around 20 percent of GDP in 2020.
- If economic and fiscal conditions allow, begin to reduce income taxes, and
- Using any further fiscal headroom - including from positive revenue surprises - to reduce net debt faster.

29. The Government's long-term fiscal objectives are to reduce net government debt below 20 percent of GDP, keep core Crown expenses below 30 percent of GDP and ensure operating balances are sufficient to meet net capital requirements, including New Zealand Superannuation Fund (NZSF) contributions in 2020/21.

30. Budget 2017 remains consistent with the Government's fiscal strategy. Preliminary economic and fiscal forecasts, accompanied by medium-term projections to 2030/31, show the Government is on track to meet its long-term objectives and the short-term intentions of maintaining rising OBEGAL surpluses and reducing net debt to around 20 percent of GDP by 2020.

31. Our objective of reducing net debt to below 20 percent of GDP is necessary in order to build resilience. Net debt increased by 20 percentage points of GDP following the Global Financial Crisis and Canterbury earthquakes. We need to rebuild the fiscal buffers to be prepared for future shocks.

New Medium Term Fiscal Priority

32. In order to keep building resilience and provide a strong fiscal anchor beyond 2020, I propose that we focus on reducing net debt to within a range of 10 to 15 percent of GDP by the middle of the next decade. This objective will complement the near term intention to reduce net debt to 20 percent of GDP by 2020.

33. The Government will aim to achieve this target by the middle of the next decade and then maintain net debt within this range. This provides a suitable fiscal buffer against economic and other shocks. If there is a significant shock, then it would be appropriate for net debt to rise above 15 percent of GDP. The Government would not be obliged to cut spending or raise taxes immediately but could allow the automatic stabilisers to cushion the impact of the shock.

34. This net debt objective does not require all projected operating surpluses be used to reduce net debt. The Government would have choices as to how to use these surpluses: to invest in public services that are required by a growing population, to invest in infrastructure to support the economy, to continue to create a fairer and more efficient tax system, to build greater resilience in the Government's

ability to respond to shocks, for example by rebuilding the National Disaster Fund or to pay down net debt at a faster rate.

35. With the projections showing that net debt is on a downward trajectory, the Treasury considers it would be appropriate to maintain levels of New Zealand Government Bonds above 20% of GDP, regardless of how far net debt falls. This would support fiscal resilience and debt management objectives, and provide broader capital market benefits.

Budget 2017 Strategy and Process

36. Budget 2017 introduced a number of positive changes to ensure greater scrutiny is applied consistently across all investment decisions. This reflects a shift in focus towards better use of evidence, more transparency around cost drivers and agencies developing a better understanding of their business and customers. The changes included the broader application of the CBAx model, greater use of expert panels in the assessment process and more transparency around future costs and benefits.

37. The four year plan is another important input which needs to be better integrated into the process for future Budgets. Where agencies have a comprehensive four year plan they are more likely able to demonstrate strategic alignment with their Budget initiatives.

38. Budget 2017 has provided a key lever in driving the behavioural change required to ensure social investment is at the front and centre of our investment in public services. This is primarily through a dedicated social investment track ('Track 1') focussed on rewarding high return and evidence based proposals which can demonstrate results for vulnerable populations.

Budget 2017 Package

39. The Budget 2017 package reflects the following key priorities:

Investing in Public Services for a Growing Country

40. The Budget 2017 package funds growth and price pressures in core services such as Health (district health boards), Education (roll growth, teacher salaries, early childhood and school operational grants) and the Justice Sector (prison musters, courts security and probation). This also includes costs associated with setting up and delivering services for children through the new Ministry for Vulnerable Children, Oranga Tamariki.

41. The package includes interventions for at-risk groups that have a strong evidence base and will deliver long-run social and fiscal benefits. The social investment initiatives include supporting innovative solutions to mental health, intervening early for children at-risk, addressing barriers to employment, and reducing criminal reoffending. Funding is also set aside to further explore investment

opportunities and build a strong evidence base for those with mental health issues [33]

Investing in Infrastructure for a Growing Economy

42. The Budget 2017 package includes funding to support increasing the supply of housing and improving transport links in Auckland, building Defence capability, tourism growth and additional funding for KiwiRail. Funding is provided to support growth in schools (within and outside of Auckland) and the health sector to keep up with rising demand for infrastructure. It also includes significant investment for the reinstatement of the Southern Corridor following the Kaikōura earthquakes.

Reducing net debt to around 20 percent of GDP by 2020

43. The Budget Economic and Fiscal Update forecasts show that the Government is on track to meet its target of reducing net debt to around 20 percent by 2020, including maintaining sufficient fiscal buffers in the face of adverse events. Beyond 2020, forecasts show net debt reduces steadily so I propose that a new debt anchor is introduced to manage net debt between 10 to 15 percent of GDP by the middle of the next decade.

Sustaining a strong economy and Supporting families to get ahead through a Family Incomes Package

44. The Budget also provides for a significant Family Incomes packages. The package will:

- provide more rewards for hard work by lowering the effective marginal tax rates for low and middle income earners to help them get ahead;
- start simplifying the tax and transfer system so incomes are more clearly linked to people's effort;
- help lower income families with young children meet their living costs, and
- improve incomes for those with high housing costs.

Key areas of operating expenditure

45. Out of the total $1.8 billion operating allowance, $1.254 billion reflects funding for the Social Sector (primarily health and education). The size of expenditure in these areas is consistent with additional Government investment required each year to respond to changes in population, inflation pressures and wage increases to incentivise better performance from the public sector.

Operating Package ($b)	Pre-commitments	Budget 2017 Funding (average per annum)	Total
Social Sector	0.225	1.034	1.259
BGA	0.001	0.288	0.289
Other	0.015	0.175	0.190
Track 1	-	0.055	0.055
Mental Health Contingency	-	0.025	0.025
[33]			
Balance	**0.241**	**1.627**	**1.868**
Savings/Revenue	-	-	*(0.070)*
Total			**1.798**

46. However, investment in these areas does not solely reflect the continuation of existing services. Budget 2017 includes funding for expanding services to cover more people and regions as well as high value investments which will help improve the delivery and quality of these services

SOCIAL SECTOR: *Responding to growth and price pressures in core services and supporting high value for money investments*	
Education ($1.072 billion over four years)	This supports 21 initiatives, with majority of funding for forecast changes to roll growth and teacher salaries, early childhood education targeted subsidies and operational grant funding for schools (the latter represents a 1.3 percent increase to funding in line with CPI). Also included is funding for special needs support and front line service delivery, departmental capacity and operating costs associated with building new schools.
Health ($2.236 billion over four years)	This supports 12 initiatives and primarily consists of funding for district health boards for pressures faced in delivering health services to a growing/ageing population. It also includes volume and price increases for disability support services, primary health care, emergency ambulance funding to eliminate single crewing and funding for additional (high value) pharmaceutical medicines.
Social Development ($137.0 million over four years)	This supports 13 initiatives, with a primary focus on funding departmental pressures and capability renewal to enable the Ministry of Social Development to better deliver core services. Funding is provided to address welfare dependency, the prevention of gang and family violence and to build social investment capability.
Justice Sector ($545 million over four years)	This supports nine initiatives with a key focus on reducing pressures on the overall justice sector pipeline. This includes funding for additional prison beds, court security officers and probation officers as well as the extension of the family violence pilot.
Vulnerable Children ($314 million over four years)	This supports 11 initiatives with a combination of funding for legislative commitments (e.g. raising the age of care and protection to 18) as well as trialling, designing and testing

	approaches for the Ministry's new operating model (e.g. reducing social worker ratio)

SOCIAL INVESTMENT: *Using the social investment approach to target vulnerable New Zealanders and supporting them to greater independence*	
Supporting innovation solutions to addressing mental health ($108.3 million over four years)	This includes investment to improve employment outcomes for those with varying degrees of mental health issues through individual placement support and supporting children with specialist needs early in the life cycle. $100 million over the forecast period has been set aside as a contingency to enable further investment in the mental health priority population group and build a stronger evidence base through pilots/trials to support the mental health strategy.
Helping kids to have a better start in life ($69.0 million over four years)	This includes a national rollout of the family start programme to ensure all eligible children can access the programme and interventions to support children with specialist needs (such as oral language problems) early in the life cycle.
Addressing Barriers to Employment and Independence ($54 million over four years)	This includes providing more intensified support for intergenerational welfare dependents aged 25-39 and supporting those who are chronically homeless through the housing first approach. It also includes funding to improve access to long-term contraception for low-income women.
Reducing reoffending and improving long-term outcomes ($90 million over four years)	This includes investment to reduce youth reoffending (prevention), more effective rehabilitation within the prison environment and effective transition pathways for those coming out of prison to reduce the chances of reoffending.

BUSINESS GROWTH AGENDA: *Investing in Services and Infrastructure for a Growing Economy*	
Export Markets ($511 million over four years)	This supports 13 initiatives, with a key focus on investing in diversification through international connectedness. Around half of the funding is going towards meeting the demand on the New Zealand Screen Production Grant – International. Also included is funding for the Trade Agenda 2030 and the Tourism Infrastructure Fund.
Infrastructure ($214 million over four years)	This support 8 initiatives, with the majority of funding going to the Housing Infrastructure concessionary charge.
Innovation ($287 million over four years)	This supports 11 initiatives, with around half of the funding going towards meeting the demand on R&D Growth Grants. It also includes significant funding for innovation and research through the Endeavour Fund and the Performance-Based Research Fund, and strategic science investment in Antarctica.
Investment ($16 million over four years)	This supports two initiatives: 1. Improving Financial Capability in New Zealand, and 2. A Multinational Corporation R&D Attraction Programme.
Natural Resources ($102 million over four years)	This supports six initiatives, with a key focus on supporting New Zealand's natural resources through investment in fisheries and native bird life. It also drives inclusive Growth for all New Zealand's people and regions through the Regional Growth Programme.
Skilled and Safe Workplaces ($118 million over four years)	This supports three initiatives with a combination of significant investment in Tertiary Education [33]

"OTHER": *Investing in Public Services for a Growing Country*	
Defence ($112 million over four years)	This investment supports a range of capabilities to support the delivery of the Defence White Paper 2016, and meeting any Defence costs that may arise between Budgets.
Māori Development ($94 million over four years, plus $8 million from the NEETs contingency)	This supports 17 initiatives, with a key focus on improving outcomes for Māori (for example housing and employment) and revitalising the Māori language.
"Other" ($51 million over four years)	This investment primarily addresses costs pressures and invests in a few high value-for-money initiatives in Vote Arts, Culture and Heritage; Finance; Internal Affairs; Pacific Peoples; Parliamentary Services; Revenue; Treaty Negotiations; and Māori Development.

Use of CBAx to inform decision-making in Budget 2017

47. In Budget 2017, Cabinet required CBAx analysis of impacts for Social Sector and "Other" initiatives. Agencies have significantly lifted the quality of their impact analysis, using the CBAx tool. CBAx makes the value and return on investment (RoI) of initiatives comparable, and the assumptions and evidence base transparent. Agencies are thinking broadly about the impacts, including across sectors and outside fiscal impacts for government.

48. The value for money (VFM) judgements considered RoI, evidence base and confidence in the assumptions, as opposed to a narrow deterministic approach, eg not RoI league tables. VFM judgements (0-5 ratings) then formed part of the advice that informed the budget packages. In addition to VFM, the Treasury factored in considerations such as strategic alignment with government priorities and implementation risks when advising on the Budget packages.

49. Ministers' use of the VFM judgements and CBAx information to inform budget decisions provides powerful incentives for improvement of analysis over time. This is essential to lift the value and outcomes for New Zealanders from public sector investments.

Key Areas of Infrastructure Expenditure

50. As our population grows we need to invest in the infrastructure to support that growth and provide capacity to grow further. Infrastructure is a core part of the Government's Business Growth Agenda and we have a very strong record in infrastructure investment. This year alone the Government's capital spend will be around $7 billion, up from $3 or $4 billion a year in recent times. This reflects our support for ultrafast broadband, the roading network, the rail network, electricity transmission, and social infrastructure like schools, hospitals and prisons. We are overseeing the biggest infrastructure programme in New Zealand in many decades.

51. Budget 2017 supports almost $4 billion in new infrastructure for our growing economy.

Capital Package ($b)	Pre-commitments	Budget 2017 Funding (average per annum)	Total
Social Sector	0.803	0.591	1.394
BGA	0.072	1.103	1.175
Other	0.204	0.429	0.633
Sub total	**1.079**	**2.123**	**3.202**
Reinstatement of the Southern Corridor	-	0.812	0.812
Balance	**1.079**	**2.935**	**4.014**

Capital Returns ($b)			Total
Expired Tagged contingencies			(0.018)

Defence			(0.020)
Total			**3.976**

52. Social infrastructure receives a large boost with five new schools, over 300 new roll growth classrooms, two school expansions as well as 11 new special education units, this is on top of $150 million for DHB capital projects [37]

Investment in tourism, which supports our export sector, includes increase maintenance of road and tourism infrastructure at New Zealand's most popular locations, new tourism infrastructure in Northland and for new Great Walks around New Zealand.

53. In line with the Government's commitment to the Defence White Paper 2016, we have invested in a range of capabilities such as the Counter Explosive Hazards Project, Underwater Intelligence, Surveillance and Reconnaissance, modernising the Delivery of Defence Force Logistics, the Frigate Communications Upgrade and the Littoral Operations Support Capability. The first part of the Defence Estate Regeneration also receives funding.

54. The Government is currently investing billions in Auckland transport – catching up on a 30 year infrastructure deficit. This is a major programme of work and significant parts of it are being completed and brought into service this year. In the capital package, we are investing in transport infrastructure around New Zealand. This includes the first commitment to the Auckland City Rail Link, support for KiwiRail Holdings Ltd and improving the safety and reliability of the Wellington Metro Rail network. Together with the support restore full access on SH1 around Kaikoura before Christmas 2017, the total funding for transport is almost $1.9 billion.

CAPITAL: *Investing in Infrastructure for a Growing Economy*	
Corrections ($763 million total)	[37]
Defence ($596 million total)	This investment supports a range of capabilities to support the delivery of the Defence White Paper 2016. This includes the following: • Counter Explosive Hazards Project. • Underwater Intelligence, Surveillance and Reconnaissance. • Modernising the Delivery of Defence Force Logistics. • Frigate Communications Upgrade. • Littoral Operations Support Capability. • Defence Estate Regeneration: projects in Tranche 1.
Education ($392 million total)	This investment supports the Schools Growth Package, which delivers: • Five new schools.

	• Two school expansions. • 305 roll growth classrooms (245 new and 60 replacement) • $26 million of land purchases. • 11 special education satellite units. • $19 million of furniture and fittings to support these schools.
Export, Natural Resources and Innovation – (BGA) ($78 million)	This investment supports initiatives in the Trade Agenda 2030, Crown irrigation schemes and initial planning for the replacement of Scott Base in Antarctica.
Health [38]	This investment supports significant District Health Board capital projects across New Zealand over the coming 12 months [38]
Justice ($22 million total)	This investment supports increasing police numbers, anti-money laundering phase II and case and evidence management systems.
Social Housing ($20 million total)	This investment supports measures to support more people in emergency housing through a tagged capital contingency to purchase emergency housing properties and pay for construction costs. This was established as a part of the Emergency Housing Package announced in November 2016.
Tourism ($41 million)	This investment supports the increase maintenance of road and tourism infrastructure at New Zealand's most popular locations, new tourism infrastructure in Northland. In addition, it will improve 20 existing short walks and 10 existing day walks and create two new Great Walks.
Transport [37]	This investment supports the reinstatement of the South Island Transport Corridors as agreed by Cabinet. It also includes specific funding for: • Support for KiwiRail Holdings Ltd. • Auckland City Rail Link. • Wellington Metro Rail.
Other Investment [38]	This investment supports the following areas: • Financial Markets Authority. • Additional Equity for Crown Asset Management Limited. • Treaty Negotiations. • Social Development. • Vulnerable Children. • Parliamentary Services. • Internal Affairs. • Finance.

Expenditure Trends in Some Key Votes

Health

55. Vote Health will receive an increase of $2.253 billion of new operating over the forecast period and $150 million of new capital in Budget 17. $1.756 billion will be provided to District Health Boards (DHBs). A further $309.9 million will help

fund cost pressures across the health sector, including disability, primary care, workforce and ambulance services. The remaining funding ($187.2 million) will fund new initiatives. DHB infrastructure is also supported, with an extra $150 million for capital investment in priority projects. In addition, we are establishing a social investment fund of $100 million over four years to support new initiatives to improve mental health outcomes. Decisions on the allocation of the contingency will be made jointly by the Minister of Health and Minister Responsible for Social Investment.

56. The Budget represents a further lift in the trend of investment in health over successive years, as demonstrated in the table below.

($m)	Four year total	Annual Average
Budget 2017	2,253.0	563.3
Budget 2016	2,221.5	555.4
Budget 2015	1,662.5	415.6
Budget 2014	1,386.4	346.6

57. The total health package in Budget 17, including the new mental health fund, is worth an average $588 million a year in new operating expenditure.

58. In addition, the government has agreed a pay equity settlement with 55,000 aged and disability care and support workers. The $2.048 billion fiscal cost over five years, of which $1.85 billion relates to Vote Health, is being managed outside Budget allowances and is in addition to the figures shown above. In its first year, the settlement will increase Vote Health operating expenditure by $279 million, raising the total Vote Health operating baseline in 2017/18 to $15.668 billion, an increase of 13.24% since 2012/13.

59. Vote Health has a fixed nominal baseline and therefore receives an annual Budget funding increase reflecting demographic growth, population ageing, wage and other pressures, and well as some discretionary funding for new initiatives. New Zealand has good health outcomes that are similar to those of comparable countries, with around median levels of both health loss and health expenditure per capita. We perform well in areas such as effective care, co-ordinated care, and efficiency.

Education

60. This Government sees education as a priority as it creates the foundation for a flourishing society and a strong economy. Therefore, we are committed to investing in what matters for supporting students to achieve.

61. In particular, this Government is committed to delivering on the current reform programme for the education system to lift student achievement. At the same

time, the education system is experiencing significant growth as a result of demographic change and this means there are a number of pressures being experienced across the system, in particular in Vote Education.

62. Therefore, in this Budget we are providing $1.1 billion in new operating [33] and $392 million in new capital funding to Vote Education aimed at not only meeting the costs of rising demand and price increases, particularly from high net migration and inflationary pressures, but also investing in those areas that support learners through the system. Included in this Budget we are investing in roll growth and teacher salaries, additional early childhood education targeted subsidies and operational grant funding for schools (the latter represents a 1.3 percent increase). Also included is funding for learning support (special education), front line service delivery, departmental capacity and operating costs associated with building new schools.

63. This Budget represents a further lift in the trend of investment in Education over successive Budgets as demonstrated in the below table:

($m)	Four year operating total[2]	Annul Average
Budget 2017	1,062.4	265.6
Budget 2016	715.6	178.9
Budget 2015	442.9	110.7
Budget 2014	831.3	207.8

64. Budget 2017 also invests $392 million in school infrastructure to stay ahead of the demand curve and provide high quality teaching and learning environments. It funds 305 roll growth classrooms throughout the country, as well as five new schools and two expansions in Auckland, Tauranga, and Central Otago. This will address demand from a growing population, and meet the Government's 2014 commitment to begin work on nine new schools in Auckland by 2019.

65. The package also provides a special education school in Auckland and 11 special education satellite units throughout the country to ensure accessibility for learners with special needs in the context of growing demand. New property for existing kura in Auckland will accommodate growth and provide a healthy and safe learning environment. Furniture, fittings and equipment grants will deliver high quality teaching and learning spaces for all these new schools.

Ministry for Vulnerable Children, Oranga Tamariki

66. The Ministry for Vulnerable Children, Oranga Tamariki, was established on 1 April 2017. The new Ministry is targeted at improving outcomes for New Zealand's most vulnerable children who are in care and protection, youth justice or who are

2 This excludes tagged contingencies mainly set aside for settling collective bargaining negotiations.

very close to those categories of need. This part of a major transformation programme to build a more child-centred and protection system, focusing on harm and trauma prevention and early intervention, rather than crisis management.

67. Budget 2017 represents the second year of significant investments in the Ministry as set out below. The amounts invested in Budget 2016 and Budget 2017 represent a 17% increase on the baseline of the former MSD for the 2017/18 financial year. MVCOT is undertaking an investment plan in its first full year of operation to inform further budget decisions in Budget 2018 and later years, as outlined in the recommendations for Vote Vulnerable Children, Oranga Tamariki.

	Amount ($m)	What is funded
Baseline from MSD for 2017/18	725.581	This is net of Budget 2016 funding.
Budget 2016	50.725 (202.900 over four years)	Funding provided for cost pressures, progressing the investing in children's programme and contingency for reforms. Out of the $141 million contingency, $22.193 million has been spent on early enhancements such as establishing the independent advocacy service and the access to services demonstration.
Budget 2017	99.627 (398.519 over four years)	Funding provided for establishment costs associated with the new agency agreed last year, cost pressures, the caregiver support package, and technology enhancements. It includes a new contingency to continue the transformation programme, including for the design of services, and the development and implementation of enhancements to service and practice.

Justice Sector

68. The Justice Sector will receive an increase of $1.2 billion of new operating funding and $785 million of new capital funding in Budget 2017 (including precommitments). The majority of this new operating expenditure relates to demand driven cost pressures across the Justice Sector, specifically in Corrections, Justice, and Courts. It also includes a large increase to Police baselines to fund the increase in Police staff numbers announced in February.

69. [37]

Funding is also being provided to Vote Justice for innovative, Social Investment-driven approaches to reducing re-offending.

70. The Justice Sector operating funding continues on an upward trajectory since Budget 2014, with the majority of new operating spending on demand-driven cost pressures and moderate investments in promising and innovative approaches to improving Justice Sector outcomes.

$m	Four-year total	Annual Average
Budget 2017	1,256.3	308.5
Budget 2016	837.0	209.3
Budget 2015	218.5	54.6
Budget 2014	11.0	2.8

Tourism Sector

71. Building on the Government's $12.000 million commitment to tourism infrastructure announced in last year's Budget, the Tourism portfolio receives an increase of $105.126 million operating over the forecast period and $41.040 million of new capital over five years in Budget 2017. This brings the Government's total operating commitment to Tourism to $182.121 per annum, which also includes significant funding for Tourism New Zealand and Ngā Haerenga, the New Zealand Cycle Trail.

72. This year the Government is launching a $102 million Tourism Infrastructure Fund to help regional communities respond to visitor growth through new tourism infrastructure. Extending this is an investment in the Department of Conservation of $44.644 million operating over the forecast period and $41.040 million of new capital over five years. The combined investment of $187 million for tourism infrastructure will help grow the tourism industry which is now a $14.5 billion export earner, and has 188,000 people working in the industry. The visitors are incredibly important to our economy, particularly in the regions.

Between Budget Spending

Between-Budget Contingency (BBC)

73. [33]

74. In line with Cabinet Office guidelines, Ministers should only seek funding from the between-Budget contingency for urgent issues that cannot be deferred. Such proposals should demonstrate that the initiative cannot be funded through reprioritisation of lower value activities. Proposals should not be submitted if the initiative could reasonably have been considered in this Budget, or was previously considered and declined.

75. Between-Budget proposals will be held to the same standards and requirements as initiatives submitted through the Budget process. Proposals must include a cost benefit analysis (using the CBAx model where appropriate) and demonstrate why they are urgent. Cabinet may provide exemptions to the requirement for cost benefit analysis where it would be impractical to undertake such analysis due to the urgency of a specific proposal [CAB-16-MIN-0307].

Mental Health Contingency

76. Budget 2017 sets aside $100 million over the next four years for investment into mental health. Mental health is a priority area for the Government however the extent and impact of unmet mental health needs is unclear and further work is required to determine the current services, the effectiveness of these and gaps that exist. The Social Investment Panel noted the lack of coherence across agencies in demonstrating an understanding of the population in the initiatives that were submitted through this Budget.

1. The Ministry of Health have started work on a cross agency mental health strategy, *'Rising to the Challenge'*. This strategy will be jointly led by the Minister of Health and Minister Responsible for Social Investment and overseen by the Social Investment Board. The strategy should help inform better investment decisions going forward. This will take time to do well. In the meantime, we want to take some steps forward to better understand the mental health landscape and fill in some of the gaps.

2. I am conscious that mental health is important across a number of portfolios and agencies which is why the contingency is not currently tagged to any specific Vote. Any investment in mental health should be in line with the cross agency mental health strategy (or help contribute to the evidence base for the strategy) and will need to meet certain assessment criteria in order to get access to funding. These will be worked through and agreed by Cabinet in due course.

Young People Not in Education, Employment or Training (NEETs) Contingency

77. Budget 2017 sets aside $50 million over four years to support further intensive investment in young people not in education, employment or training (NEETs). Similar to mental health, this contingency will support cross agency initiatives aimed at supporting these young people in specific regions. This will require an understanding of the current services being delivered in those regions and their effectiveness. Initiatives will need to meet specific criteria in order to get access to funding.

78. $8.0 million of this contingency will be ring-fenced for the 'Passport to Life' initiative in Vote Maori Development.

Moratorium on Papers with Financial Implications

79. Once the Budget 2017 package has been agreed by Cabinet, production of the Budget documents must be completed. In order to ensure that the documentation tabled in the House of Representatives on Budget Day is accurate, Ministers should not submit papers that have fiscal and/or appropriation implications for agreement by Cabinet Committees or Cabinet between now and Thursday 25 May 2017.

Consultation

80. This paper was prepared by the Treasury. The Budget package has been developed in line with the overall strategy agreed by Cabinet in September 2016, submissions in Four Year Plans, separate Cabinet consideration of some proposals, and a series of meetings between Ministers.

Legislative Implications

81. The Appropriation (2017/18 Estimates) Bill, the Appropriation (2016/17 Supplementary Estimates) Bill, the Imprest Supply (First for 2017/18) Bill and the Imprest Supply (Second for 2017/18) Bill will give effect to Budget 2017.

82. Legislation will be required to effect to the Family Incomes Package.

Regulatory Impact Analysis

83. There are no regulatory requirements for this paper.

Publicity

84. Budget Day is Thursday 25 May. The Office of the Minister of Finance coordinates all communications relating to Budget 2017, including requests for early announcements. Written approval from the Prime Minister and me is required for any early announcements.

Recommendations

85. I recommend that Cabinet:

87.1 **note** that Budget 2017 supports investment in the following key priorities:

i. Delivering better public services for a growing country, using a social investment approach

ii. Investing in infrastructure to support a growing economy

iii. Supporting families to get ahead through the Family Incomes Package

iv. Reducing net debt to around 20 percent of GDP by 2020 then to 10 to 15 percent of GDP by the middle of the next decade

Fiscal Strategy

87.2 **note** that the economic and fiscal outlook is positive and the Government is on track to meet its debt target;

87.3 **note** that higher levels of economic activity and terms of trade is likely to increase nominal GDP cumulatively by a net $17 billion compared to the Half Year Update across the five years to June 2021;

87.4 **note** that final economic forecasts and fiscal forecasts for the Budget Economic and Fiscal Update are to be completed on Tuesday 18 April and Wednesday 3 May respectively;

87.5 **note** that this fiscal headroom provides choices to the Government on where investment should be targeted to support a strongly growing population and economy;

87.6 **agree** to increase the operating allowance for Budget 2017 to $1.8 billion (an increase of $300 million)

87.7 **agree** to increase the operating allowance from Budget 2018 to $1.7 billion (an increase of $200 million), rising by 2 percent each Budget thereafter;

87.8 **agree** to increase the capital allowance from Budget 2017 to $4 billion to accommodate investment in response to the Kaikoura earthquakes;

87.9 **note** the capital allowance in Budget 2018 remains unchanged;

87.10 **agree** to increase the capital allowance from Budget 2019 onwards to $2.5 billion (an increase of $500 million);

87.11 **note** that the Government's fiscal strategy puts greater emphasis on building resilience and providing a stronger fiscal anchor beyond 2020;

87.12 **agree** on the new long-term debt objective , to reduce net debt to within a range of 10 to 15 percent of GDP;

87.13 **note** that the Government will aim to achieve this target by the middle of the next decade and then maintain net debt within this range;

87.14 **authorise** the Minister of Finance to finalise the fiscal priorities and future allowances for inclusion into the Fiscal Strategy Report; and

87.15 **agree** to a Government commitment aiming to maintain levels of New Zealand Government Bonds (NZGBs) above 20 percent of GDP over time.

Budget 2017 Package

87.16 **note** Budget 2017 provides for five key packages of new spending:

i. Social Sector - $1.259 billion.

ii. Social Investment ('Track 1') – $55 million.

iii. Business Growth Agenda - $289 million.

iv. Defence, Maori Development and Other - $190 million.

v. Capital - $3.976 billion

87.17 **note** that new operating spending proposals in Budget 2017, net of any savings and revenue, result in an increase in spending of $1.798 billion a year on average over the forecast period;

87.18 **note** that new capital investment, net of any savings, to be announced at Budget 2017 totals $3.976 billion;

87.19 **agree** to both the operating and capital initiatives for Budget 2017 as set out in the financial recommendations accompanying this paper;

87.20 **agree** that expenses or capital expenditure against appropriations and capital injection authorisations set out in the 2017/18 Estimates and being sought in that Bill may be met from Imprest Supply until the Appropriation (2016/17 Estimates) Bill is enacted; and

87.21 **authorise** the Minister of Finance and relevant Appropriation Ministers to approve changes to initiatives and appropriations where this proves necessary to finalise the 2017 Budget package;

Track 1

87.22 **agree** that funding cannot be drawn-down for the Track 1 initiatives set out in Annex 1 until a sufficient and robust evaluation plan, as defined and assessed by the Treasury, has been provided for that initiative;

87.23 **note** that a sufficient and robust evaluation plan must include a reporting schedule outlining what will be reported at each stage of the initiative's implementation;

87.24 **delegate** responsibility to approve the evaluation plan for all Track 1 initiatives to the Secretary of the Treasury;

87.25 **direct** the Treasury to report back to SOC by 31 January 2018 with a progress report on the funded Track One initiatives;

87.26 **direct** agencies with Track 1 initiatives to provide the Treasury with the information required for the report-back in recommendation 27 above;

87.27 **direct** all Track 1 initiatives to report the findings from their evaluation process to their responsible Minister, copied to the

Minister of Finance, in accordance with the timeframes set out in the evaluation plan;

87.28 **note** that where an initiative is not on track to achieve its proposed impacts/benefits (including the identified fiscal savings) the report will either outline the actions being undertaken to ensure that the impacts/benefits are ultimately achieved, or provide options for discontinuing the initiative or for reprioritising the funding; and

87.29 **direct** all Track One initiatives to publically report the findings from their evaluation process at least one year following each key reporting stage;

Mental Health and NEETs Contingency

87.30 **agree** to establish a cross agency contingency for the Mental Health and NEETs priority population groups with the following profile;

	$ million increase/(decrease)			
	2017/18	2018/19	2019/20	2020/21 & Outyears
Mental Health	25.000	25.000	25.000	25.000
NEETs	12.500	12.500	12.500	12.500

87.31 **agree** that the expiry date for these contingencies be extended to 30 June 2019;

87.32 **agree** to ring-fence $2.0 million of the NEETs tagged contingency for the 'Passports for Life' Maori Development initiative;

87.33 **note** that initiatives will need to meet certain assessment criteria and conditions in order to get access to funding from both these contingencies and these will be approved by Cabinet in due course;

General Matters

[33]

87.35 **agree** that:

i. proposals for funding from the between-Budget contingencies must be for urgent issues that cannot be deferred to Budget 2018; and

ii. Ministers will be expected to demonstrate that they have exhausted their search for opportunities to fund the initiative through reprioritisation of lower value activities;

87.36 **agree** that no papers with fiscal and/or appropriation implications for agreement by Cabinet or Cabinet committees be submitted between 18 April 2017 and 25 May 2017 so that Budget documentation is accurate;

87.37 **note** that all communications relating to Budget 2017 are coordinated by a Budget communications committee, and that any requests for early announcement will need to have both the written approval of the Minister of Finance and sign-off from the Prime Minister's office; and

87.38 **invite** the Minister of Finance to introduce the Appropriation (2017/18 Estimates) Bill, the Appropriation (2016/17 Supplementary Estimates) Bill, the Imprest Supply (First for 2017/18) Bill and the Imprest Supply (Second for 2017/18) Bill to give effect to Budget 2017.

Hon Steven Joyce
Minister of Finance

Date: 18 April 2017

Annex 1: Track 1 Initiatives

- Increasing contraceptive access for low income women (Health)
- Investment Approach to Justice – Reducing Youth Offending (Justice)
- Investment Approach to Justice: Burglary Prevention Case (Justice)
- Early Identification and Removal of Communication Barriers to the Curriculum (Education)
- National Coverage for Family Start (Vulnerable Children)
- Intensive Client Support (Social Development)
- Transforming intervention and support for at-risk prisoners (Corrections)
- Individual Placement Support (IPS) for Clients with Mental Health Conditions (Social Development)
- Enhancing Industry, Treatment, and Learning interventions (Corrections)
- Creating Positive Pathways for People with a Corrections History (Housing)
- Incredible Years – expanding programmes to meet specific needs (Education)
- Housing First (Housing)
- Behavioural Services (Education)