

The Treasury

Budget 2017 Information Release

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[40]	Not in scope	

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Treasury Report: Budget 2017 - Preliminary Funding Assessments

Date:	2 February 2017	Report No:	T2017/116
		File Number:	BM-2-1-2017

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Steven Joyce)	Note the preliminary funding assessments of Track 2 initiatives Discuss with officials at Fiscal Issues on Tuesday 7 February	Tuesday 7 February
Associate Minister of Finance (Hon Simon Bridges)	Note the preliminary funding assessments of Track 2 initiatives Discuss with officials at Fiscal Issues on Tuesday 7 February	Tuesday 7 February
Associate Minister of Finance (Hon Amy Adams)	Note the preliminary funding assessments of Track 2 initiatives Discuss with officials at Fiscal Issues on Tuesday 7 February	Tuesday 7 February

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
[23]		[39]	N/A (mob)
Kamlesh Patel	Team Leader, Budget Coordination		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: Yes

Treasury Report: Budget 2017 - Indicative Funding Assessments

Executive Summary

This report provides an outline of how much funding Treasury is likely to support for Track 2 initiatives that have been submitted so far. It is still quite early in the decision-making process and therefore the preliminary funding amount is likely to move around as new initiatives come in, costs associated with existing initiatives change or further information is provided to the Treasury from departments to inform assessments. The next update will be provided to you at Fiscal Issues and Budget Ministers on Tuesday 14 February.

Out of the nearly \$2.9 billion of Track 2 operating initiatives, [33]

The assessments have not yet been finalised by Treasury sector teams, and they do not constitute Treasury advice about the size and shape of an overall Budget package. Further, a number of initiatives still need to be assessed as they have come in later in the process including:

- [33]
The Treasury will provide a preliminary assessment of Track 1 initiatives at the next Fiscal Issues on 14 February.
- **Kaikōura earthquakes:** agencies were asked to signal preliminary initiatives on 31 January. [33]
The latter is primarily driven by the reinstatement costs of SH1.

On the capital side, around \$10.437 billion worth of funding requests have been submitted or signalled by agencies [33]

. Major cost components include the reinstatement of SH1 following the Kaikōura earthquakes, Defence, City Rail Link and the Auckland Housing Programme.

After Budget 2017 pre-commitments there is \$1.259 billion left in the operating allowance and \$2.001 billion left in the capital allowance.

Overall, both the operating and capital allowances are already heavily oversubscribed and, as the decision-making phase progresses, Treasury will provide further advice on various Budget packages and the choices and trade-offs required to deliver within the allowances.

Alongside Budget initiatives, there are a number of additional fiscal risks which will need to be managed including Terranova, Southern Response and potential additional costs associated with the Housing Infrastructure Fund. As the Budget package is developed, consideration will need to be given to how these risks (if they eventuate) are treated in relation to both the operating and capital allowances.

Recommended Action

We recommend that you:

- a **note** that at 31 January the total funding for Track 2 initiatives sought from Budget 2017 is \$2.852 billion per annum over four years in operating expenditure and \$10.437 billion in capital expenditure
- b **note** that the [33]
- c **note** that the preliminary assessment excludes the following initiatives: Track 1; Kaikōura earthquake; Māori development initiatives and initiatives submitted after the 27th of January
- d **note** that at 31 January [33]
- e **note** that at 31 January [33]
- f **note** that the assessments are subject to change, and a further update, including value for money judgements and CBAX insights, will be provided to you on at Fiscal Issues and Budget Ministers on the Tuesday 14 February
- g **note** that the December Budget Policy Statement set the Budget 2017 operating allowance at \$1.5 billion and the Budget 2017 Capital allowance at \$3 billion
- h **note** that after pre-commitments there is \$1.259 billion left in the operating allowance and \$2.001 billion left in the capital allowance
- i **note** that the Treasury is providing further advice informed by the Peer Review Process on initiatives for each of the six BGA workstream Ministerial group for their mid-February meetings

Kamlesh Patel
Team Leader, Budget Coordination

Steven Joyce
Minister of Finance

Treasury Report: Budget 2017 - Indicative Funding Assessments

Purpose of Report

1. This report provides an overview of how much funding the Treasury is likely to support for Track 2 initiatives based on the preliminary assessment of Treasury Vote Analysts (VAs). The assessments have not yet been finalised by VAs, and they do not constitute Treasury advice about the size and shape of an overall Budget package. A further update will be provided to you on these initiatives at Fiscal Issues and Budget Ministers on Tuesday 14 February.
2. The report also provides an update on Track 1 and initiatives relating to the Kaikōura Earthquakes.

Overview

3. At the chew session with Treasury officials on Tuesday 10 January you asked for an early indication on how much is likely to be funded as part of the operating and capital Budget allowances. The Treasury has completed preliminary assessments of Track 2 initiatives to provide an overview of how the packages are coming together in the early stages of the decision-making process.
4. **The assessments are preliminary only and are based on initiatives submitted before Friday 27 January.** There are likely to be initiatives which are submitted after this date, changes to the fiscal cost of existing initiatives, or more information provided to Treasury which can impact on the final assessment. For example, for some initiatives that are partially supported it is not clear what the cost breakdown of the initiative is and therefore the final funding amount could change significantly.
5. The graphs below provide an overview of:
 - a The total amount of funding sought by agencies (by workstream)
 - b How much funding the Treasury is *likely* to support, and
 - c How this compares to the operating and capital allowance (including any precommitments).

[33]

6. The Treasury Preliminary Assessment column in the above graphs do not include a preliminary assessment of the following initiatives:
- a **Track 1:** final initiatives were submitted to Treasury on 31 January and are still being assessed by sector teams. [33]

 - b **Kaikōura Earthquakes:** a preliminary list of initiatives (including indicative fiscal costs) were due with Treasury on 31 January, with final initiatives due on 14 February. [33]

 - c **Māori Development:** these initiatives were submitted to Treasury late in the process and are still being assessed by sector teams. 39 Māori development initiatives have been signalled seeking \$129 million per annum over four years in operating expenditure.

- d **Initiatives submitted after 27 January:** these initiatives were submitted to Treasury late in the process and are still being assessed by sector teams (also excludes the between-Budget contingency with is \$50 million per annum over four years).
- 7. Overall, the preliminary assessment shows that both the capital and operating allowances are oversubscribed, and this is without including some key initiatives as described in paragraph 6. This is more acute for capital investment where over \$10 billion worth of initiatives have been submitted.
- 8. The above graphs also do not include other fiscal risks or costs associated with commitments that the Government has already made (for example, the Housing Infrastructure Fund). An outline of potential fiscal risks that need to be considered in addition to Budget initiatives is provided at the end of this report.
- 9. The total amount of funding supported by Treasury is subject to change as final assessments are completed for all initiatives across Track 1, Track 2 and the Kaikōura Earthquakes. A further update will be provided to you on these initiatives at Fiscal Issues and Budget Ministers on Tuesday 14 February.

Workstream analysis

- 10. Treasury considers a range of information when assessing initiatives. Budget 2017 steps up CBA and CBAX information to inform value for money (VFM) judgements and investment decisions. Completing a CBA is required for all initiatives and CBAX is required for the social sector and “Other” initiatives. Treasury will advise Ministers on the VFM judgements of each initiative. VFM judgements consider return on investment, assumptions and the evidence base. Indications are that departments have completed CBAXs well. Superu review indicates that the evidence base for the problem and target population is generally strong, but generally weak for the solution, counter factual and impacts.

Social Sector Preliminary Assessment

- 11. [33]
- 12.
- 13. Further, four new social sector initiatives have been submitted since 27 January which still require a Treasury assessment. We will provide you with further advice on potential packages as assessments are finalised.

BGA Preliminary Assessment

20. The Business Growth Agenda (BGA) has provided a strong organising framework for delivering the Government's economic growth agenda. Economic agencies are currently refreshing the BGA. BGA Ministers have expressed their intention for the BGA Refresh themes to shape the BGA Budget package.

21. [33]

22. The below graph breaks down the funding sought per annum with Treasury's preliminary assessment of what is likely to be supported.

[33]

23. To help meet Ministers' expectations for improved analytical frameworks for the BGA Budget process, the Treasury has run a Peer Review Process for selected Budget initiatives. The initiatives were selected based on the fiscal impact, policy significance, and the quality of evidence provided. The Peer Reviewers met with agency officials to discuss the relevant Budget initiatives and test the underlying assumptions. The assessment by the Peer Reviewers will inform the Treasury's advice going to Ministers in February.

24. The Treasury is currently conducting detailed assessments of BGA Budget initiatives on their value for money and strategic fit with the 2017 BGA Refresh. We will provide advice to each of the workstream Ministerial meetings in February. Following the discussions by workstream Ministers, the Treasury will update BGA Ministers on the emerging BGA package in March. The BGA Leadership Group¹ will provide advice to BGA Ministers on the overall BGA package and its fit with the BGA vision and 2017 Refresh themes.

Key themes and observations in the BGA Budget stream

25. As with Budgets 2015 and 2016, sought funding for innovation remains a significant focus for new investment. Budget 2017 proposed initiatives build **on existing investments in innovation** by increasing funding for the Growth Grants programme, the Endeavour Fund and incentivising partnerships in R&D investments. [33]

The package of proposed initiatives in Building Export Markets contributes towards **New Zealand's international connections**. The key vehicles for this are strengthening trade policy strategy, growing capability through expanding our offshore footprint, growing higher value exports, realising tourism's full potential and growing the international education market for New Zealand education institutions. [33]

27. The set of proposed initiatives in the Building Skilled and Safe Workplaces workstream focus on strengthening the **transition from secondary school to higher education and into the workforce**. [33]

28. [33]

- 29.

“Other” Preliminary Assessment

30. [33]

¹ The BGA Leadership Group comprises of CEs the Treasury, MBIE, MFAT, NZTE, MPI, and MfE

[33]

Capital Preliminary Assessment

35. The initiatives for new capital funding submitted across all votes total \$10.437 billion. These figures do not include Track 1 initiatives (this is expected to be minor), nor earthquake and resilience related initiatives (discussed later in the Kaikōura Earthquake section).

36. [33]

(this excludes fiscally neutral recommendations).
These assessments have not yet been finalised, and they do not constitute Treasury advice about the size and shape of an overall Budget capital package. Capital related operating funding for each initiative is reflected in the associated Social Sector, BGA or Other package.

37. At HYEPU, the capital allowances were raised to \$3 billion in Budget 2017 and \$2 billion onwards. **The remaining Budget 2017 capital allowance after precommitments is \$2.001 billion.**

[33]

38. **BGA Infrastructure** is seeking [33] of funding, [33]
The main elements of this package are:

- a **Auckland City Rail Link** - \$1.744 billion. The HYEPU reflected this funding as spread across Budgets 2017 – 2020. As the costs of the project are still being finalised, the Crown's contribution is not yet reflected as a pre-commitment against Budget 2017. The Ministry of Transport and the Treasury will provide further advice on the cost of the project in March 2017, followed by a Cabinet paper seeking agreement to the final amount.

The provisional funding in *Figure 6* reflects \$436 million investment (consistent with the treatment at HYEPU).

- b [38]

- c **Support of the Rail Freight Business – KiwiRail** - [33] . The Treasury has not yet completed its preliminary assessment of this initiative and the full amount of funding has been reflected in the preliminary funding in *Figure 6*.

We are currently waiting on further information from KiwiRail and will provide further advice in due course.

39. **Defence** is seeking [33] , of which we provisionally support funding [33] billion. The Treasury has provided further advice on the components of this investment (T2017/43 and T2017/81 refer). [33] billion of the funding sought and precommitments on the Budget 2017 capital allowance for Defence total \$194 million. In addition to this, the Defence White Paper has forecast significant ongoing capital injections for the Defence Force out to 2029/30.
40. **Vote Health** is seeking [33] for the District Health Board capital investment pool, of which we provisionally support funding [33] (2017/18 funding). This funding would support investment in [33] Sustained capital pressures are expected in Vote Health over future Budgets and this will include investment sought for the Dunedin Hospital.
41. **Vote Education** is seeking [33] funding for school infrastructure, of which we provisionally support funding [33] The Treasury is engaging with the Ministry of Education to consider a more conservative intermediate option for investment. The initiative includes a departmental operating injection to support the delivery of a larger scale capital programme. Vote Education has submitted other Budget initiatives related to departmental operating injections for current infrastructure service delivery levels, and [33] these may impact on the school infrastructure initiative.
42. The major capital component of the “Other” package is for Vote Parliamentary [33]

Precommitments

43. Around \$962.582 million of operating funding over the forecast period and \$999.317 million of capital funding has been pre-committed against Budget 2017 allowances.
44. The operating funding is being driven by the Housing, Welfare, Treaty and Justice sectors. The capital funding is being driven by the Justice and Defence sectors.

45. If commitments to the City Rail Link and Education forecast changes are included, the remaining allowances for Budget 2017 total:

(\$million)	2017 Operating Allowance	2017 Capital Allowance
Recommended in the BPS Cabinet paper	1,500	3,000
Agreed Pre-commitments	(241)	(999)
Remaining Allowances Available	1,259	2,001
<i>Potential Pre-commitments:</i>		
Education forecast changes ²	(192)	-
City Rail Link ³	-	(436)
Remaining Allowances Available	1,067	1,565

Track 1 Update

46. Final Track 1 initiatives were submitted by agencies on 31 January and are currently being assessed by Treasury. [33]

Figure 6

provides a breakdown of these fiscal costs by sector.

[33]

47. Key initiatives contributing to this cost include: extension of the family start programme, re-setting work expectations and expanding and targeting behaviour services for children with behavioural difficulties. A preliminary assessment of Track 1 initiatives (in particular which ones are likely to meet the threshold) will be provided at the next Fiscal Issues on Tuesday 14 February.

² Note Education forecast changes have been entered as a Budget Initiative (consistent with the treatment in previous Budgets), however there is very little discretion around this under current policy settings.

³ This has not been agreed by Cabinet as a precommitment against the capital allowance, however the Government has already announced plans to cost share with the Auckland City Council.

Kaikōura Earthquakes

48. Earthquake and resilience related initiatives will run through the main Budget process as much as possible. This allows for Ministers to consider the initiatives as a package, within the context of other Budget investment decisions.
49. The Treasury asked agencies to submit preliminary earthquake initiatives on Tuesday 31 January to get an early indication of both the size and quantity of proposals that may come in. [33]

Costs associated with the reinstatement of SH1 make up a large proportion of the total capital costs. Note that we expect several further initiatives to be entered. More detail on the process, initiatives and some key points for discussion are included in the aide memoire T2017/109.

50. Agencies have until 14 February to submit final earthquake initiatives, following which they will be assessed by the Treasury and the Capital Investment Panel. Panel and Treasury advice will be provided by Investment Ministers. The Treasury will provide further advice to Ministers as initiatives come in and assessments are finalised.

Fiscal Risks

51. There are a number of moving parts that will need to be considered alongside these initiatives and priorities, as the Budget packages shape up through the decision-making phase of the Budget. These include:
 - a **Housing Infrastructure Fund:** based on previous Cabinet decisions, the \$1 billion Fund will be treated as fiscally neutral over 10 years, as councils would repay the loans within 10 years (refer CAB-16-MIN-0683.01). [33]

Given that Cabinet has committed to an interest free loan funding mechanism, this component has minimal discretion and will impact the operating allowance in 2017/18. The call for final proposals was released on 1st February and submissions from councils will be received by 31 March. These will be assessed by the Independent Assessment Panel.

51. There are a number of moving parts that will need to be considered alongside these initiatives and priorities, as the Budget packages shape up through the decision-making phase of the Budget. These include:
 - b **Terranova:** the bids discussed in this paper do not include the cost of a negotiated settlement in Terranova, last estimated at [33] per annum over four years (with a rising profile and higher out-year costs). The Ministry of Health have not submitted a bid for this, but it will require funding if agreement is reached. Decisions will be needed in due course about whether costs are managed inside the operating allowance; and also whether to build the rising the cost profile into baselines (a bit like Vote Education cost pressures) or deal with it through incremental Budget increases (the standard approach for other Vote Health cost pressures). The HYEPU forecasts have built in an estimate of the Terranova settlement.

- c **ACC Non Earners Account:** an increase of \$182 million in 2017/18 (\$565m over the forecast period) is being sought at Budget 17 to help fund the lifetime cost of ACC non-earners claims.⁴ This bid assumes discount rates as at June 2016, which were at a Brexit low, and is driven by a solvency adjustment to compensate for the resulting increase in the estimated liability. Discount rates, and Account solvency, have subsequently rebounded. Ministers therefore have options about how much, if any, additional funding is provided for the Account. Should Ministers wish to consider a funding increase, we recommend seeking further information from ACC on the solvency impacts of assuming a higher discount rate. There is also a choice whether this is inside or outside allowances.
- d **Earthquake Commission:** as a result of the Kaikōura / Culverden earthquakes, EQC are forecast to exhaust their cash assets in ¹³⁷¹ Treasury has recommended that funding be provided to meet the asset deficiency in the form of an operating grant, rather than a capital grant or a loan (that would be repaid and be considered fiscally neutral). Compared with the other options, an operating grant provides the necessary flexibility to allow EQC to discharge its claims obligations and minimise the guarantee being called again in the short term, whilst allowing for fairer sharing of costs and risks between tax and levy payers (additional reasoning is given in T2016/2487). Based on this approach, an impact of up to ^[33] on Budget allowances is expected (noting that there is significant variability in the forecasts which are based on probability analysis). Whilst Minister Joyce has agreed with the recommendation of an operating grant, a decision is yet to be made by Minister Brownlee (a meeting to discuss the advice is yet to be confirmed). Upon agreement of the mechanism, updated cash flow forecasts will be requested from EQC and a further update will be provided to Ministers. The Ministers' decision and the form and mechanics of payment will then be formally communicated to the EQC Board. We expect these forecast numbers to be firmed up in the next month.
- e **Southern Response:** as with Budget 2016, the fiscal implications of a possible increase of up to ^[34] in Southern Response's uncalled capital facility do not count against allowances as they are considered valuation changes. However it would impact on the fiscal indicators of core crown net debt as the capital is drawn down. Southern response is still working through the estimated drawdown timeline, this effects the fair value calculation of the payable and the interest unwind calculation both needing to be revised upwards in BEFU. The SRES board is expected to consider its capital requirements on 24 February 2017 and the Treasury will provide an updated assessment in light of any request for additional support from the company.
- f **Other Earthquake Implications:** as outlined in the following section, HYEPU included net \$1 billion in the forecasts. The Government has taken policy decisions on reinstating the southern corridors [CAB-16-MIN-0675 refers], the level of funding currently sought is ^[33] but is subject to confirmation. The Treasury will continue to provide updates on KiwiRail, SH1 and earthquake resilience later in February and in March. Further advice will be provided on funding options for earthquake initiatives, from within Budget allowances or otherwise, in the likely event overall costs exceed a net \$1 billion.

⁴ Based on ACC's initial assessment of its cost pressures, we previously indicated a possible Budget bid of over \$500m in 2017/18 for the Non-Earners' Account. The bid is smaller than indicated because it reflects the application of a proposed new Non-Earners' Account funding policy [T2016/2142 and T2016/2039 refer].

g [33]

52. Budget Ministers will have options as the Budget packages come together and the Treasury's preliminary and final forecasts are confirmed. Refer T2017/54.

Annex: Already agreed to pre-commitments against the Budget 2017 operating and capital allowances:

Sector	Initiative	Indicative amount over forecast period (\$m) 2016/17 - 2020/21	Date agreed by Cabinet
Commerce	Financial Markets Authority Funding and Levy, External Reporting	Capital – 2.250	October 2016
Housing	Emergency Housing	Operating – 184.000 Capital – 20.000	September 2016
Corrections	[33]		
Welfare	Corporate Services for Oranga Tamariki	Operating – 84.149	October 2016
Defence	Counter Explosive Hazards Project	Capital – 28.238	July 2016
	Underwater Intelligence, Surveillance and Reconnaissance	Capital – 36.111	July 2016
	Modernising the Delivery of New Zealand Defence Force Logistics: Approval to Implement	Capital – 130.000	December 2016
Justice	Family Violence	Operating – 132.109	August 2016
	Investment in Policing	Operating – 484.388 Capital – 19.418	January 2017
Economic Development	Extending Earthquake Support for the Kaikōura Region	Operating – 5.000	December 2016
Treaty	Increase to the Whanganui Quantum	Operating – 26.620	December 2016
	Hauraki Negotiations Final Decisions	Operating – 26.188	November 2016
	Reconciliation Process and Crown Support Package	Operating – 3.000	November 2016
TOTAL		[33]	