Reference: 20140294

11 February 2015

Thank you for your Official Information Act request, received on 25 November 2014. You requested the following:

> *"... any advice Treasury has given to the Government on achieving a return to a budget surplus for this 2014/15 financial year. Please limit the scope of your search to all advice provided since January 1, 2014."*

On 19 December 2014, an extension of 20 working days was requested. A response to your request is due by 12 February 2015.

Information Being Released

Please find enclosed the following documents:

Item	Date	Document Description	Decision
1.	10 March 2014	Building the Buffer – Note to Minister of Finance's office on Monday 10 March 2014	Release in full
2.	20 March 2014	March Baseline Update and Impact on the In-Year Revisions Position	Release in part
3.	8 April 2014	Forecasting OBEGAL in the Pre-Election Update	Release in full
4.	8 April 2014	Risks to the 2014/15 Surplus	Release in part
5.	28 July 2014	2014/15 - options (updated 30 July)	Release in part
6.	24 October 2014	Levers for responding to forecast deterioration	Release in part
7.	3 November 2014	Options/levers - responding to prelim fiscals HYEFU 2014	Release in part

Please note that the options presented in these documents do not reflect recommendations prepared by the Treasury, but are options prepared for the Government should they have wished to pursue any.

I have decided to release the relevant parts of the documents listed above, subject to information being withheld under one or more of the following sections of the Official Information Act, as applicable:

- section 9(2)(f)(iv) – to maintain the current constitutional conventions protecting the confidentiality of advice tendered by Ministers and officials, and
- section 9(2)(b)(ii) – to protect information where the making available of the information would be likely unreasonably to prejudice the commercial position of the person who supplied or who is the subject of the information.

Information Publicly Available

In addition, the information listed in the table below is also covered by the request and is available on the Treasury website.

Item	Date	Document Description	Website Address
8.	31 March 2014	A package that delivers a surplus *(Proactively released in July alongside other key documents from Budget 2014)*	http://www.treasury.govt.nz/publications/informationreleases/budget/2014/key

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury website.

This fully covers the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Simon McLoughlin
Team Leader, Fiscal and State Sector Management

Information Being Released
TOIA 20140294

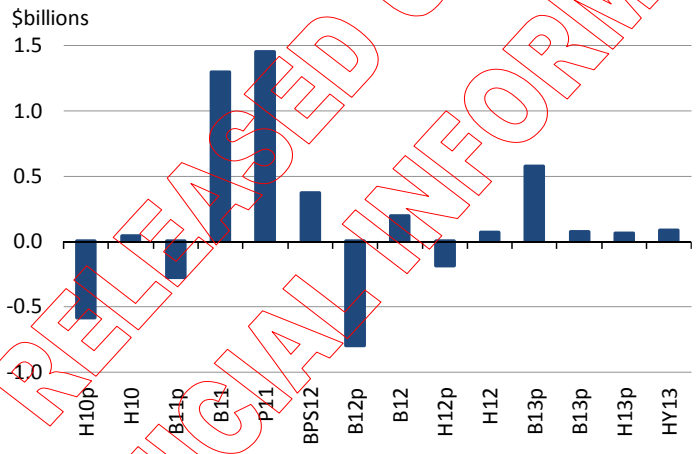
BUILDING THE BUFFER IN 2014/15

This is an initial list of possible options that could be implemented in Budget 2014 to build the buffer for OBEGAL in 2014/15, which was forecast at $86m in HYEFU 2013 (0.04% of GDP and less than 0.1% of total Crown expenses). These numbers are high level estimates but do provide an idea of scale.

We would recommend that these options be implemented as part of a BEFU rather than PREFU given the ability to make policy changes in Budget is greater than PREFU. The best way to help ensure an OBEGAL surplus in 2014/15 is forecast in PREFU is therefore to build a larger buffer in BEFU 2014.

Forecasts evolve over time as assumptions are updated. Typical changes between forecast rounds average around ±$400m (see graph of OBEGAL forecasts over time below) so a surplus of around $500m would help guard against adverse movements between BEFU and PREFU. Preliminary fiscal forecasts for BEFU 2014 are due on 20 March.

Total Crown OBEGAL forecasts for 2014/15 in every round since HYEFU 2010



Notes: p=preliminarily if available, B=Budget, H=HYEFU, P=PREFU, BPS=Budget Policy Statement

In addition to suggestions for reducing expenditure and increasing revenue, we have also included options around altering the timing of current initiatives:

Expenses

- Budget 2014 package: $100m-$200m – a smaller package than the current $1b per year. This could involve reducing discretionary initiatives (eg, keeping to the low-spend BGA package would save around $100m).

  or

  A profile that has a smaller impact in 2014/15, but remains $4b in total across the forecast period. The rising profile of expenditure already committed (education and defence) means keeping to a $1b average is likely to result in an impact of around $900m in 2014/15.

- March Baseline Update 2014: around $100m – we are closely examining expense transfers and retention of underspends into 2014/15 and will present options (the majority of underspends are likely to be already excluded from the forecast as part of the top-down adjustment so only a fraction of savings will flow to OBEGAL).

- An initial examination of other items in the March Baseline Update has identified the following options (which may save up to $60m in 2014/15):

  - **Overseas Development Assistance:** $33m increase in 2014/15 (Multi Year Appropriation, or MYA, rephasing).
    - Option: Move underspends into 2015/16. This should be considered alongside options around the Budget initiative for additional funding for Official Development Assistance.

  - **CERA:** $20m increase in 2014/15 (MYA rephasing) for the Avon River Precinct. Unclear how discretionary this rephasing is.
    - Option: Transfer $20m into 2015/16.

  - **Primary Growth Partnership:** $4.4m increase in 2014/15 (MYA rephasing).
    - Option: Transfer $4.4m into 2015/16.

  - **Contestable Waste Minimisation Fund:** $2.1m increase in 2014/15 as a technical adjustment.
    - Option: Transfer $2.1m into 2015/16.

- Tagged contingencies: $60m – shift out associated expenditure in 2014/15 to 2015/16, although there is some pressure from Christchurch-related spending currently in 2013/14 being moved into 2014/15.

- Funds (Justice Sector Fund, BPS Seed Fund): $50m – could close for one year, or push spending out to 2015/16.

  - BPS has $20m sitting in 2014/15, although some will already be committed.
  - Justice sector had $60m transferred to 2014/15.

- IRD bad debt write-off (implement from 1 July 2014): $40m – with costs falling in 2015/16 and outyears. The fiscal impacts are uncertain and need to be followed up with IRD.

- Other expense options could include looking at: other MYA rephasing, grant schemes, efficiency dividends, and EECA/Business Energy Efficiency.

Revenue

- ACC levies: estimated $100m – HYEFU 2013 included reductions of $387m in the 2014/15 levy year rising to $1b from the 2015/16 levy year. The main options include not doing any levy reductions in the 2015/16 levy year or focusing the levy reductions on motor vehicle levies (which start from 1 July 2015). The remainder of planned reductions (or any further reductions) could occur in the 2016/17 levy year.

  Given expectations of higher ACC costs in the preliminary forecasts (OBEGAL reduced by $130m in 2014/15), you could also link the second round of reductions to the performance of the Corporation to mitigate the risk of continued reduced profitability.

- Higher excise rates:

  - On alcohol (50% increase could give up to $400m per year)
  - Tobacco
  - Road-user charges

- Higher levy rates:

  - For royalties
  - International travel (departure tax)
  - EQC levies (currently forecast at around $270m in 2014/15 – around $150m was raised when levies were increased significantly in early 2012)

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ORIGINAL

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: March Baseline Update and Impact on the In-Year Revisions Position

[Information not within scope]

[Pages 2 & 3 not within scope]

[Information not within scope]

Impact on 2014/15

Expense transfers and retention of underspends

17. In the 2013 OBU letters you indicated to agencies the significant risk expense transfers poses to the fiscal forecasts, and signalled that you would only be approving expense transfers where agencies could prove that a factor outside of their control was the primary cause of the delay. Consequently, we have applied increased scrutiny when assessing agencies requests for transfers or retention of underspends in this baseline update process.

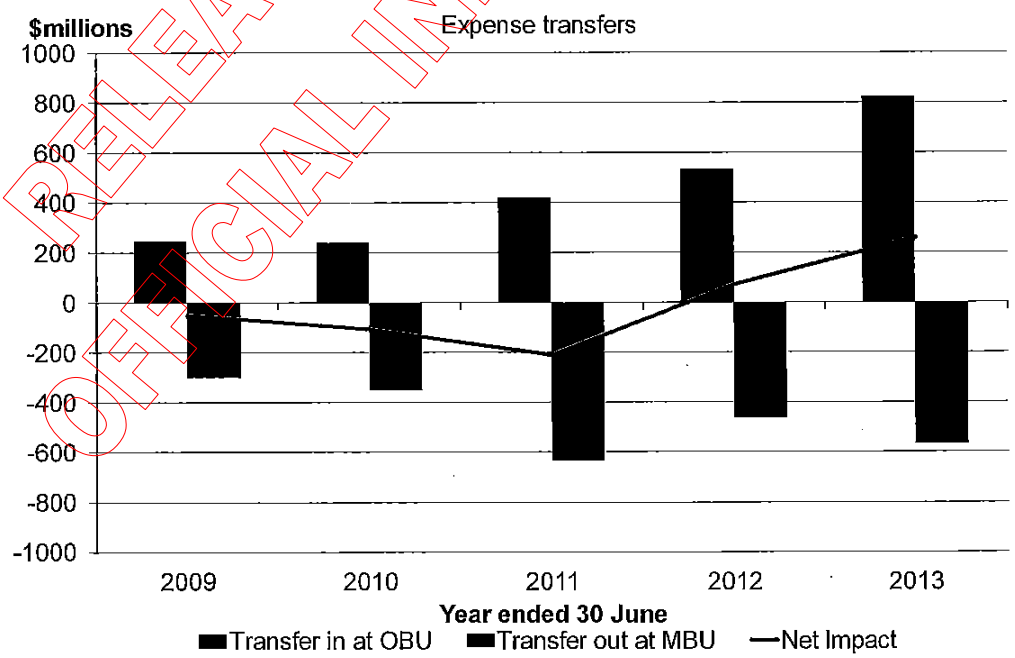
18. The Treasury currently applies a 'top-down adjustment' to the forecasts to reflect that, among other things, the majority of underspends are not spent and continue to carry forward from year to year. This top-down adjustment effectively reverses the transfer at a whole of government level. As a result, a decrease in the level of transfers or underspends will not necessarily directly impact the Operating Balance before Gains and Losses (OBEGAL). Instead, it is likely that a decrease in the underspend will result in a corresponding decrease in the top-down adjustment, negating any impact on OBEGAL.

19. While there might not be a direct operating gain from reducing underspends, it is vital from a fiscal management perspective that departmental baselines fairly reflect the level of spending required for departments to deliver their outcomes. Scrutiny of underspends promotes good fiscal management practice as departments must display a good knowledge of their cost drivers and fiscal position. The responsibility for managing baselines is therefore directed where it should be, at departments, rather than placing reliance on a central adjustment mechanism.

20. The top-down adjustment assumes that agencies will continue to carry forward transfers and underspends from year to year. However, as long as departments retain the authority to spend previous underspends there is a risk that, contrary to past behaviour, departments will unexpectedly increase their spending in a particular year. Were this to happen, the government's expenditure might exceed forecasts. Adjusting baselines to a more realistic level mitigates this risk.

21. As the Figure 1 below shows, the trend over the last two years suggests that departments may be starting to catch up slightly on spending, as expenses transferred in have been more than what is being transferred out.

Figure 1: Expense transfer impact 2009–2013



22. To further reinforce this message around the importance of accurate forecasting, we have included on your behalf a short paragraph in each of the attached response letters asking Ministers to engage with their agencies on the accuracy of their five-year fiscal forecasts.

23. The total impact and timing of expense transfers and retention of underspends, both actual and in-principle, sought in MBU is set out in Table 3 below. (Note that actual and in-principle capital transfers are excluded, as they do not impact on OBEGAL.)

Table 3: Operating Actual and In-Principle Expense Transfers and Retention of Underspends Profile

	$ million increase/(decrease)				
	2013/14	2014/15	2015/16	2016/17	2017/18
Expense Transfers Impact	(396.3)	257.0	116.7	17.4	5.2
Retention of Underspends Impact	(32.9)	32.9	-	-	-
In-Principle Expense Transfers Impact	(284.2)	273.0	5.1	1.0	5.1
In-Principle Retention of Underspends Impact	(1.2)	0.6	-	-	-
Total Net Impact	**(714.6)**	**563.5**	**121.8**	**18.4**	**10.3**

24. We have identified a number of transfers that we do not support, because they do not meet the criteria for Joint ministerial approval under Cabinet delegation. There are also a number of underspends we recommend be transferred into the Justice Sector Fund, which would allow you more control over prioritisation across the sector. These are discussed in more detail below.

25. We have classified all remaining requests for actual and in-principle expense transfers and retention of underspends into two categories:

    a. 'Non-discretionary' – where not approving the transfer will either risk service delivery failure or the agency has significant pressures that cannot be met from their baseline.

    b. 'Discretionary' – representing requests that meet the rules in CO (11) 6, are in line with current policy objectives, and will assist departments in alleviating cost pressures, but will not lead to service delivery failure if not approved. A complete list of transfers we have identified as 'discretionary' can be found in Annex Two.

26. We recommend that transfers identified as non-discretionary be approved, as not doing so would risk service delivery failure. If you wished to further reduce the risk to the fiscal forecasts, you could look to decline some or all of the transfers identified as discretionary.

27. It should be noted that there is a risk that declining discretionary transfers will incentivise agencies to increase their expenditure in the remaining quarter of 2013/14. It is possible that such expenditure would be low-value.

28. Should you decide to decline some or all of these transfers, we will work with your office to reflect these decisions in the relevant response letters.

[Pages 7 -118 not within scope]

BUDGET SENSITIVE

FISCAL ISSUES 8 APRIL 2014

FORECASTING OBEGAL IN THE PRE-ELECTION UPDATE

The purpose of this note is to summarise the potential risks that could impact on the forecast operating balance before gains and losses (OBEGAL) for 2014/15 at the Pre-election Update (PREFU). PREFU is due for release between 11 – 22 August 2014.

This note focuses on risks at a high level and provides an assessment of their potential impact and what an appropriate buffer would be to mitigate the risk of forecasting an OBEGAL deficit at the PREFU, given there is little opportunity to make policy changes. We are currently in the process of preparing the specific fiscal risk chapter for the 2014 Budget Update, which provides more detail of individual risks that could impact the fiscal outlook.

To determine what may change between Budget and the PREFU we've looked at areas that have been most susceptible to change in recent forecast rounds (refer to the attached A3). There are a lot of potential outcomes and given the uniqueness of a PREFU it is difficult to confidently predict the outcome. However we've used our judgement and experience to come up with reasonable forecast bounds. The major risk to returning to surplus continues to be the variability of tax revenue forecasts.

The timing of the 2014 PREFU is similar to the 2005 PREFU, which resulted in an increase in the OBERAC (the precursor to OBEGAL) of $628 million in 2005/06 from the previous Budget. The most significant forecast change was increased tax revenue of $731 million. Looking at the 2011 PREFU, the OBEGAL moved down by $1,068 million with most of the change due to revisions in Canterbury earthquake costs.

Typical changes to OBEGAL between forecasts rounds average around ± $400 million. The level of a buffer to ensure a forecast surplus at PREFU depends on the level of risk you are willing to take. If you wanted to protect against a situation where everything that could go wrong (barring extreme economic shocks such as a repeat of a GFC-like event or the outbreak of severe agricultural or human carried diseases), does go wrong, then you may want to have a buffer as high as $1 billion.

However, it is worth highlighting the following factors which mitigate the risk:

- The closeness between the Budget Update and the PREFU (compared to usual forecast round) will limit the amount of new information available to incorporate into the forecasts, which could restrict changes between the two forecast rounds.

- With 2014/15 now only one year away, the uncertainty in the current forecasts is likely to have reduced from previous forecasts.

- There are some eventualities that could have secondary offsetting impacts on OBEGAL. A good example of this is if interest rates are forecast to be higher

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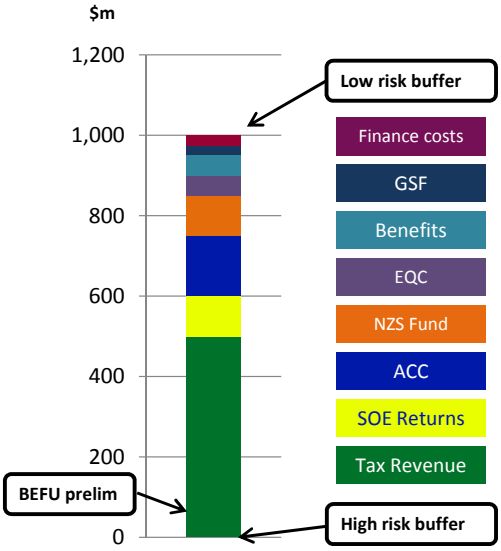
than expected. While this would have adverse impacts on net finance costs, it would be partly offset by a positive impact on resident withholding tax revenue.

- Movements could just as easily be positive as negative. Any buffer will increase the surplus in the event movements are positive.

Given these factors a buffer of around $400 million - $500 million appears reasonable.

PRE-ELECTION FORECASTS

Cumulative effect of possible changes to the 2014/15 OBEGAL



This chart adds up the potential impacts on OBEGAL if all of the risks we've noted were to eventuate.

Tax Revenue

Based on past forecast rounds tax revenue is most likely to be the most material change at PREFU. In the last three forecast rounds tax revenue have moved by:

- -$620 million in the 2013/14 year (prelim Budget 2014)
- -$108 million in the 2013/14 year (Half Year Update 2013)
- +$910 million in the 2012/13 year (Budget 2013)

Currently tax revenue for the 2013/14 year has been running behind forecast (around $1.1 billion at February) and were revised down by $0.6 billion in the preliminary fiscal forecasts. There is a risk the current variance does not narrow as much as anticipated, with flow on impacts into 2014/15.

The other critical factor which will influence tax revenue forecasts at PREFU is the economic outlook. There are a number of economic data releases which could change our view on the economic outlook for 2014/15 and therefore flow through to the tax revenue forecasts. Notable data releases between Budget and Pre-EFU are:

- CPI for the March quarter (16 April) and the June quarter (16 July)
- Labour market release for March quarter (7 May)
- GDP for the March quarter (19 June)
- Other data releases include dairy auction and migration data.

Overall, we think tax revenue could potentially move by around **$500 million** based on average changes in the last three forecast rounds, however it could easily be higher or lower given the size of the tax revenue base.

SOE Returns

The main risk will be around the financial performance of Solid Energy. Last year an asset impairment of around $300 million was recorded. *[Withheld under s9(2)(b)(ii)]*

Some SOE's may update their forecasts between BEFU and PREFU which will need to be incorporated into the forecasts. However this likely to only occur with a few entities rather than across the sector.

Overall a buffer of **$100 million** would be prudent to cover both eventualities.

NZS Fund Interest Income

In recent forecast rounds the NZS Fund has shifted more of its asset portfolio from interest bearing assets to equity holdings. If the strength in equity markets persistent there is an incentive for the NZS Fund to move more of its portfolio into equity investment which would decrease interest income. Previous revisions have been roughly around **$100 million** per year.

GSF Expenses

The GSF unfunded liability will be valued as at 30 June 2014 for inclusion in the year end financial statements. If short-term interest rates are higher than expected this could lead to an increase in expenses due to the interest unwind of the liability. The maximum risk in 2014/15 is likely to be around **$25 million**.

Benefit Expenses

Benefit expenses are unlikely to change significantly between forecast rounds. With benefit rates locked in for most of the 2014/15 year the key risk will be around changes in recipient numbers (mainly in jobseeker support benefits). Changes in recipient numbers will be influenced by updated outturn data and the economic outlook.

The other potential change in benefit expenses could come from KiwiSaver, however given the upward revision (around $100m per year) at Budget we're not expected to much change at PREFU.

We think there is a low risk of a large movement in benefit expenses, so would consider **$50 million** a reasonable change between forecasts given the size of the benefit base.

ACC results

There are two main risks to ACC's forecast results. Firstly, the ACC unfunded liability will be valued as at 30 June 2014 for inclusion in the year end financial statements. The updated valuation could potential have flow on impacts to 2014/15 through changes in the unexpired risk liability and discount rate unwind. The valuation will also provide updated data around claims experience (e.g. cost of claims and length of time claimants are in the scheme) which could impact on insurance costs going forward.

In addition, similar to the NZS Fund, ACC have also been shifting more of its asset portfolio from interest bearing to equity holdings.

Looking at previous changes in ACC's current year forecasts it is possible the 2014/15 forecasts could move around **$150 million**.

EQC insurance expense

The most significant risk will be changes in the timing of the risk margin release.

At the moment a large risk margin release is expected through 2014/15 (around $230 million), however if claim settlements take longer than expected it could mean the unwind could shift into 2015/16. The assumptions around claim settlements will be largely driven by actual experience. The valuation (including these assumptions) will be updated by year end.

The full amount of the unwind in 2014/15 is unlikely to be at risk, the most reasonably scenario could see around **$50 million** of the unwind not happen.

Earthquake recovery

Risks remain in respect to both the magnitude of costs and timing or recovery costs. For 2014/15 the two key risk will be if the rebuild happens faster than expected (which will move expenses forward) and managing horizontal infrastructure costs within the $1.8 billion Christchurch City Council cost sharing agreement.

We are unlikely to have a great deal of new information on the above risks to factor into the PREFU forecasts reducing the risk that the forecast will change.

Student loans and tax impairment

IRD will be carrying out impairment testing for major Crown assets (namely student loans and tax receivable) for the 30 June 2014 financial statements. The outcome of the valuations are unlikely to significant change IRD's view of impairments for 2014/15, as they would need more evidence on the collectability through the year before making any revisions.

Other items

The PREFU will need to capture all government decisions made between Budget day and our Pre-EFU fiscal forecast finalisation date. We are aware there could potentially be significant policy decisions taken around social housing and the ACC funding review during this time.

A general contingency of $50 million has been set aside at Budget 2014 to manage new decisions. It is worth noting that the contingency is usually overspent (e.g. the Budget 13 contingency is currently overspent by around $120 million). However, given this risk is within the Government's control and there will be limited time for Cabinet decisions before PREFU we believe the risk of overspending is low.

There is also a risk that there could be one-off events that occur which could impact on our PREFU forecasts. Previous examples of such events include company bail-outs and the Canterbury earthquakes. It is difficult to quantify the risks from these events which makes it hard to know what an appropriate buffer would be. Generally the probability of one-off events are low, however there impact can be significant.

We'll also need to consider an appropriate top-down adjustment at PREFU. We think the chances of the impact of the top-down changing from Budget is relatively low.

Net finance costs

The two key factors that could move the forecasts for net finance costs are changes in interest rates and funding requirements. The funding requirements will be dependant on what the 2013/14 closing net debt is an whether the cash requirements for 2014/15 change. If the tax and benefit impacts were to happen as above then the borrowing programme would need to increase by around $550 million, which could add around **$25 million** to finance costs in 2014/15. Changes in net finance costs from interest rate changes are likely to be somewhat offset by increases in RWT revenue so we expect this risk to be minimal.

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2014/15 – options

Updated 30 July 2014

Treasury's previous advice has been that a change in fiscal policy is not necessary to offset a lower OBEGAL such as that expected in the current forecast round. From an economic management and fiscal credibility perspective, the change in OBEGAL is likely to be small and is unlikely to be interpreted as a change in the Government's commitment to its medium-term fiscal strategy.

However, this note outlines a list of options developed by the Treasury which you could use to respond to any deterioration in the forecasts with little or no impact on your key Government priorities.

Please note that these options have been developed internally through a desktop exercise and there has been no consultation with relevant Ministers or departments. Consultation is likely to be required to firm up feasibility and the specific financial implications before progressing these options.

[Withheld under s9(2)(f)(iv)]

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[Withheld under s9(2)(f)(iv)]

Interaction with the top-down adjustment

Treasury applies a 'top-down adjustment' to the forecasts to reflect the fact that entities have a history of over-forecasting (i.e. the top-down reflects underspends that continue to be carried forward year after year). When the top-down adjustment is calculated, specific entities are targeted. What this means for PREFU options, is that to make a material impact on the forecasts, the savings options for these targeted entities will need to total more than the top-down applied.

BEFU 2014 Top-down adjustment for 2014/15:

Opex $million	**2014/15**
Targeted	
NZ Defence Force	50
Education	100
MFAT	60
Health	150
Transport	15
Primary Industries	50
CERA	75
MBIE	125
Total Targeted entities	
Unallocated top-down adjustment	250
Total Opex	**875**

For example, to have a material impact on the fiscal forecasts, savings options taken with respect to MFAT will only improve OBEGAL for every dollar over $60 million. However, agencies like MSD or Treaty Settlements, where no targeted top-down adjustment in 2014/15 is applied, every dollar of saving impacts OBEGAL.

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Process for finalisation of the fiscal forecasts:

Key dates:

Date	Process
Wednesday, 30 July	Early fiscal heads-up (1)
Thursday, 31 July	Fiscal Issues (12.30pm)
Friday, 1 August	Early fiscal heads-up (2)
Monday, 4 August	Fiscal Issues (10am) Cabinet delegation for PREFU decisions Fiscal forecasts communicated
Week of 4 August	Any decisions taken to be incorporated into the PREFU
Monday, 11 August	Report back to Cabinet on any decisions taken under delegation
Tuesday, 19 August	PREFU released

We have prepared a paper for you to take to Cabinet on 4 August which seeks delegation to Budget Ministers to take decisions in the week of 4 August for incorporation into the PREFU forecasts, if required.

[Pages 4 -20 withheld under s9(2)(f)(iv)]

BUDGET-SENSITIVE

Levers for responding to forecast deterioration

For discussion at Fiscal Issues, 29 October 2014

This note outlines some levers for responding to any forecast deterioration in the upcoming Half Year Update.

Early indications are that the reduced tax revenue in 2014/15 (around $800 million) is likely to be weaker on a consolidated basis as departments have increased their estimate of GST. The lowering of the interest rate forecasts are expected to have a short term negative impact on net interest costs with interest revenue being more sensitive to change than finance costs. In addition, we are seeing some initial increases in core Crown expenses in 2014/15 but are currently investigating those movements in conjunction with finalising our top-down adjustment. Overall we are expecting 2014/15 to be significantly weaker than the Pre-election Update. With regards to the outyears the deterioration of tax revenue is unlikely to be mitigated by other forecast movements.

Although the forecasts are still to be finalised, there are some key messages below that could be helpful when talking to your colleagues in the coming weeks:

- **Surplus for 2014/15 is at risk:** revenue is subject to significant downside risk in HYEFU and expenditure is unlikely to offset this.
- **Uncertainty remains high:** outlook may worsen before it gets better or it may turn around quickly (though may be less likely).
- **Target:** the surplus target is "subject to any significant shocks" – the 50% fall in dairy prices since February and soft CPI inflation have contributed to an $18 billion hole in the nominal economy since Budget 2014 over the forecast period.
- **Focus on medium-term position:** although they will have worsened, debt tracks are likely to still be prudent with no immediate need to respond to a deterioration from an economic management and fiscal credibility perspective.

In the case of needing to turn around a small-to-moderate deficit, some initial options are presented below. This will help us understand which levers are available for fuller consideration in November.

- **2014/15:** while there is no immediate need to respond, meeting the commitment may be positive for short-term credibility and help constrain spending for the remainder of the 2014/15 financial year. Options include:
  - **Increasing Revenue:** *[Withheld under s9(2)(f)(iv)]*
  - **Decreasing Expense** *[Withheld under s9(2)(f)(iv)]*

- **2015/16 and outyears:** options addressing the 2014/15 deterioration should ideally help or not overly worsen the 2015/16 position given it is also subject to risk. Although there are more options for that year including the Budget 2015 allowance (still at $1.5 billion in the forecasts), there are also a range of upcoming policy changes that could impact on 2015/16 *[Withheld under s9(2)(f)(iv)]* .

- **Wider considerations:** some options have implications for four-year plans now being drafted; ongoing savings can be used to offset the Budget 2015 package; full advice on fiscal strategy and capital will be provided by 7 November.

Please note that these initial options have been developed internally through a desktop exercise and there has been no consultation with relevant Ministers or departments. Consultation will be required to firm up feasibility and implications before progressing.

Interaction with the top-down adjustment

Treasury applies a 'top-down adjustment' to the expense forecasts in 2014/15 of around $900 million to reflect the fact that entities have a history of over-forecasting (ie, the top-down reflects underspends that continue to be carried forward year after year). While the top-down results in more accurate forecasts it does mean that any adjustments to department baselines and appropriations (including an efficiency dividend) would have to be large (to counter the affect of the top-down adjustment) or targeted at areas where the baselines currently reflect the expected spend (and therefore no top-down exists).

HYEFU timetable

The timeframe for making decisions on the current HYEFU timetable, particularly any with legislative implications, will be tight. However, there is flexibility to make adjustments to this timetable to ensure the HYEFU is the best possible reflection of the economic and fiscal outlook, including the impact of government policy.

Current Date	Process
Friday, 31 October	Early fiscal heads-up (preliminary)
Monday, 3 November	Preliminary fiscal forecasts
Monday, 10 November	**Economic forecasts finalised**
Friday, 14 November	**Tax forecasts finalised**
Friday, 21 November	Early fiscal heads-up (final)
Monday, 24 November	**Fiscal forecasts finalised**
Friday, 5 December	Near-final HYEFU to Minister of Finance
Monday, 8 December	Statement of Responsibility signed (MoF, Treasury Secretary) Final Budget Policy Statement (BPS) MoF sign-off
Tuesday, 16 December	**HYEFU and BPS released**

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Options and levers ahead of the final fiscal forecasts

For discussion, 7 November 2014

This note discusses the preliminary forecasts for HYEFU, particularly developments around core Crown expenses. It explains some of the changes to expenses since PREFU and what options there may be ahead of the final forecasts.

Core Crown expenses are forecast to continue to decline as a share of GDP, from 31.2% to 29.8% by 2018/19, in line with your expense intentions. Core Crown expenses are expected to be around $350 million higher in 2014/15 compared with PREFU, but slightly lower over the forecast period as a whole. This partly reflects lower benefit expenses as there is a lower wage track to which New Zealand Superannuation is indexed and lower recipient numbers for sole parent support due to a more positive employment outlook.

However, lower export prices and a softer inflation outlook have led to weaker forecasts of tax revenue. As a result, preliminary fiscal forecasts are showing an OBEGAL deficit in 2014/15 of $1.0 billion and suggest a surplus will be difficult without tough decisions or favourable surprises to revenue or expenses.

Options to contain the 2014/15 deterioration should ideally help or not overly worsen the 2015/16 position, given preliminary forecasts show a $101 million deficit in 2015/16. (These forecasts include a $1.5 billion operating allowance for Budgets 2015-17. A $1 billion allowance for Budget 2015 and 2016, in line with recent signals, would see a forecast surplus of around $300-400 million for 2015/16 and $2.2 billion in 2016/17.)

While expenditure restraint is on track, there have also been some cumulatively significant movements on the expense side. Core Crown expenses have come in higher by around $350 million in 2014/15, mainly due to the carrying forward of underspends from 2013/14 and rephasing of multi-year appropriations (MYAs). More detail about the most significant movements can be found in Annex Two.

Summary of savings options

These options are discussed in more detail in Annex One. This annex also provides an explanation of the process required around progressing each of these options.

[Withheld under s9(2)(f)(iv)]

We should also note that since our discussion on Tuesday, MBIE have resubmitted their forecasts to reflect a reduction in spending of about $75 million in 2014/15. However the reduction is unlikely to have a fiscal impact as most of the reduction related to items we have identified as being unlikely to be spent, and therefore has been captured in the top-down adjustment.

Understanding the increase in core Crown expenses

Under Cabinet Office Circular CO(11)06, joint Ministerial approval is required for expense transfers (ET) or retention of underspends (ROU). Where an agency is seeking an ET or an ROU, the Minister of Finance has full discretion over the approval of these movements.

However, with MYAs, Parliament has authorised the government to spread the amount of the MYA across years. The allocation to each financial year covered by the MYA is the responsibility of the Minister responsible for the appropriation (rather than a joint Ministers decision). To influence this, the Minister of Finance would need to initiate a discussion with the appropriation Minister and jointly agree to change the phasing across outyears. If Ministers wanted to 'stop' a movement from 2013/14 to 2014/15, this would require a decision to reduce the total amount of the appropriation.

In Treasury's view MYAs are appropriate for multi-year finite projects whose overall cost is fixed and clear but the split of that cost between individual financial years is not. Examples of this appropriate use are the MYAs in Vote Canterbury Earthquake Recovery for the development costs of the various anchor projects. However, agencies have a history of poorly forecasting MYAs and often front load the profiles. This history of front loading feeds into the calculation of the top-down adjustment.

In our view a succession of MYAs is not appropriate for expenditure that is intended to be ongoing. With ongoing expenditure, ETs and ROUs can be used to provide flexibility across years. These movements are fiscally neutral across the forecast period and allowable under the fiscal management approach as they do not ultimately impact on government debt.

The flexibility tools available to agencies in CO(11)06 are designed to reflect Cabinet's intention to increase flexibility of financial management for Ministers and departments, and to that extent assist in the ability to manage within fixed nominal baselines.

We should note that CO(11)06 is currently under review and so far internal discussions suggest that this flexibility is something we support and may recommend increasing in certain instances. You will have an opportunity to comment on this review in the next month.

BUDGET-SENSITIVE

HYEFU timetable

The timeframe for making decisions on the current HYEFU timetable, particularly any with legislative implications, will be tight. However, there is flexibility to make adjustments to this timetable to ensure the HYEFU is the best possible reflection of the economic and fiscal outlook, including the impact of government policy.

Current Date	Process
Monday, 3 November	Preliminary fiscal forecasts
Monday, 10 November	**Economic forecasts finalised**
Friday, 14 November	**Tax forecasts finalised**
Friday, 21 November	Early fiscal heads-up (final)
Monday, 24 November	**Fiscal forecasts finalised**
Friday, 5 December	Near-final HYEFU to Minister of Finance
Monday, 8 December	Statement of Responsibility signed (MoF, Treasury Secretary) Final Budget Policy Statement (BPS) MoF sign-off
Tuesday, 16 December	**HYEFU released**

Budget Policy Statement timeline

Current Date	Process
Friday, 7 November	Road check report (with projections assumptions appendix)
Friday, 21 November	Draft Budget Policy Statement to Minister of Finance
Monday, 24 November	Cabinet Paper [timing TBC]
Tuesday, 25 November	Budget Policy Statement at Fiscal Issues
Tuesday, 2 December	Final BPS at Fiscal Issues
Monday, 8 December	BPS sign-off by Minister of Finance
Tuesday, 16 December	**BPS released**

[Pages 4 - 9 withheld under s9(2)(f)(iv)]