BRIEFING FOR SENIOR MINISTERS' MEETING ON THE 2008 BUDGET PACKAGE

5:00 P.M. TUESDAY 18 MARCH 2008

INCLUDES A REVISED TABLE ON PAGE 7 AND TEXT ON PAGE 6
AS A RESULT OF THE REVISED JANUARY CROWN ACCOUNTS

Agenda

Senior Ministers are meeting on Tuesday 18 March to consider the emerging 2008 Budget package prior to the package being considered by Cabinet in April.

This paper presents details of proposed packages for Families Young and Old, Economic Transformation, National Identity, Health, Other and Capital. Senior Ministers are asked to take decisions on the content of these packages to be considered by Cabinet in April, including any changes to initiatives at the margins.

Once Senior Ministers have taken these decisions, officials will prepare a Cabinet paper on the proposed 2008 Budget package, including detailed financial recommendations for each initiative. This paper is scheduled to be considered by the Cabinet Policy Committee on 9 April and by Cabinet on 14 April.

A suggested format for this meeting is:

1. **Macroeconomic and fiscal context.** Senior Ministers may wish to discuss the macroeconomic and fiscal context within which Budget decisions are being taken (p. 5).

2. **Overview of theme packages.** Senior Ministers may wish to note the highlights and key trade-offs of each proposed theme package:

3. **Consideration of marginal initiatives.** Annexes A to G present information on the individual initiatives within proposed theme packages, grouped in the following categories:

    - Initiatives that are the highest priority within proposed packages (in green);
    - Initiatives that are within proposed packages, but at the margin (in yellow); and
    - Marginal initiatives that are not within proposed packages (in orange).

    Senior Ministers may wish to work through each annex, confirming the green sections and indicating any changes that should be made to the placement of marginal initiatives in the yellow and orange sections.

Recommendations

It is recommended that Senior Ministers:

a **note** that in revising its economic forecasts, Treasury's initial view is that economic growth will slow more than previously expected due to drought conditions, weaker world growth and pressure on consumers from interest rates and petrol prices, and that inflation pressures remain high;

b **note** that these weaker growth forecasts would have an impact on tax revenue, restricting fiscal headroom and underscoring the importance of remaining broadly within Budget allowances;

c **note** that the theme packages proposed in this paper would lead to the operating allowance being overspent by $350 million over the forecast period (but only by $20 million in outyears), and the capital allowance being overspent by $389 million:

	$ millions					
	2007/08	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**Total**
Operating funding for Budget 2008	50	3,015	3,071	3,083	3,122	12,342
Pre-commitments (Business Tax, MFAT, Defence)	43	1,161	1,267	1,279	1,295	5,046
Proposed packages						
Families - Young and Old	(31)	359	436	495	522	1,781
Economic Transformation (Innovation)	(6)	182	175	175	175	702
Economic Transformation (Other)	1	80	48	31	23	183
National Identity	(62)	112	23	24	23	120
Other	178	111	140	115	124	669
Health	-	750	750	750	750	3,000
Estimated cost of tax policy changes	-	283	93	86	81	542
Post Budget 2008 contingency	-	200	150	150	150	650
Under/(Overspend)	**(73)**	**(223)**	**(11)**	**(22)**	**(20)**	**(350)**
Capital funding for Budget 2008	48	992	330	200	230	1,800
Proposed package	70	1,205	477	226	112	2,089
Post Budget 2008 contingency	-	50	50	-	-	100
Under/(Overspend)	**(22)**	**(263)**	**(197)**	**(26)**	**118**	**(389)**
Total *Under/(Overspend)*	**(95)**	**(486)**	**(209)**	**(47)**	**98**	**(739)**

d **note** that the figures in recommendation (c) above do not factor in any funding for broadband or for purchasing Toll NZ assets;

e **agree** to the theme packages as set out in recommendation (c) above, and in Annexes A to G, being used as the basis for the 2008 Budget package to be considered by Cabinet on 14 April;

f **indicate** in Annexes A to G any changes that you wish to make to proposed theme packages, e.g. removing yellow marginal initiatives from packages to create fiscal headroom, or adding orange marginal initiatives into packages;

g **note** that while the following initiatives are included in the proposed capital package, associated operating funding has not made the cut in the proposed theme packages so the initiatives will not be able to proceed:

- *National Library:* Building a National Library for the 21st Century
  $51 million capital is included in the proposed capital package for a full building redevelopment, which would require $7 million of ongoing operating. Only $3.5 million operating has been included in the proposed National Identity package; this would be enough to address storage issues. Addressing storage issues would only require $7 million capital;

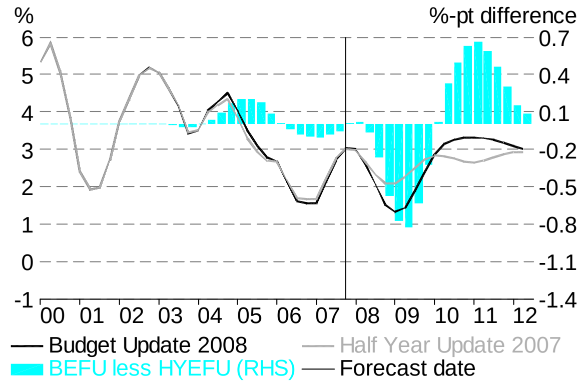
[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

h **note** that the Minister of Finance will shortly receive more detailed advice on fiscal headroom from the Treasury, which will be available to inform Cabinet consideration of the 2008 Budget package as a whole.

Economic growth to slow more than expected in the short term …

Treasury is currently revising its economic forecasts for the *Budget Update*. Their initial view is that economic activity over the year ahead will slow more than previously expected but then rebound again in 2009/10. Annual CPI inflation is expected to exceed or remain near the top of the 1-3% target band.

Real GDP growth



The international outlook – particularly for the United States – is expected to weigh on export prices and volumes, although resilience in Asia and Australia acts as an important buffer. Domestically, the housing market has slowed markedly and is having a dampening effect on household spending. Credit conditions have also tightened accentuating the headwinds facing both households and firms. Dry weather conditions are expected to reduce agricultural production and weigh on electricity generation over coming quarters.

The high terms of trade, ongoing labour market strength, government spending and assumed personal tax reductions[1] are expected to provide some offset to these negative forces, particularly over the year to March 2010 and beyond. Over the year ahead the negative forces are expected to dominate.

… and inflation pressures remain high.

Notwithstanding a weaker outlook for activity, CPI inflation is now expected to be higher over much of the forecast period, and above 3% over 2008. This reflects the combined impact of existing capacity pressures, rising food and energy prices, elevated inflation expectations and the introduction of the Emissions Trading Scheme. Ninety-day interest rates are expected to remain around current levels until mid-2009.

Treasury sees the main risks to this picture of the economy as being on the downside to activity – in terms of a deeper and protracted period of slow growth – and on the upside with respect to inflation over the year ahead. While the former is still considered low probability, if it were to eventuate it could pose relatively significant risks to activity and employment.

The main downside risk relates to the possibility of more negative and widespread effects coming from weakness in the United States economy and the disruption to the credit generating process that has helped support global growth over recent years. At

[1] The *Budget Update* forecasts contain an assumption for personal tax reductions. Households are assumed to benefit from higher disposable incomes of around $2 billion in the year to March 2010, rising to around $3 billion in the year to March 2011 and $4 billion in the year to March 2012. This assumption is larger than that used in the *Half Year Update* where the increase in disposable incomes was around $1.5 billion per year from the year to March 2010.

this stage, the Australian and Asian economies remain strong and New Zealand's export commodity prices look well supported. However, domestic credit conditions are tightening.

The housing market correction that is well underway also has the potential to see a larger decline in house prices than assumed, with obvious negative implications for residential investment and consumption. The ongoing strength in the labour market and assumed tax cuts represent a key buffer for household behaviour.

After adjusting for data revisions, Treasury expects total nominal GDP over the forecast period to be $8 billion lower when compared with the *Half Year Update*. This is expected to result in around $1.4 billion less tax revenue over the forecast period, though there would be no reduction in the final forecast year, which drives the amount of ongoing fiscal headroom.

Fiscal headroom is constrained, reflecting a larger assumed personal tax package, lower tax revenue forecasts and a higher KiwiSaver uptake.

The increased size of the assumed personal tax reductions and expected lower tax revenue mentioned above flow through into Treasury's preliminary fiscal forecasts, which are set out in the table on page 7.

The operating balance before gains and losses (OBEGAL) is now forecast to decline to a small surplus of around $0.8 billion in 2011/12, while the ratio of gross sovereign issued debt (excluding settlement cash) to GDP is forecast to fluctuate around 18% over the forecast period. Net core Crown debt to GDP increases by around 3% over the period.

The OBEGAL for the 2008/09 year is expected to be around $1 billion lower than the *Half Year Update* and $3.1 billion lower in 2011/12. The changes in the forecasts are driven by changed policy assumptions and forecast changes, in particular:

- the increased size of the assumed personal tax reductions account for around half of the total change over the forecast period;
- the downward revision to tax revenue forecasts account for around a quarter of the change; and
- increases in KiwiSaver contributions, reflecting higher than expected uptake, account for around a tenth of the change.

The cash balance from 2008/09 is also lower than the *Half Year Update* by between $2 billion and $3 billion in each year. On an accumulated basis by the end of the forecast period the cash position is around $10 billion lower than the *Half Year Update*.

The increase in the cash shortfall since the *Half Year Update* is met by running down financial assets built up over recent years and issuing debt. As a result, gross sovereign issued debt (excluding settlement cash) and net core Crown debt increase since the *Half Year Update* by around $5 billion and $10 billion respectively by 2011/12.

Given the Government's intention to announce personal tax cuts in Budget 2008, these developments underscore the importance of agreeing to theme packages that broadly fit within the Budget allowances set in December.

	2007 Actual $m	2008 Forecast $m	2009 Forecast $m	2010 Forecast $m	2011 Forecast $m	2012 Forecast $m
OBEGAL						
Preliminary Budget Update	5,339	6,229	3,330	2,108	1,053	755
Half Year Update	5,339	6,574	4,327	4,062	3,984	3,850
	-	(345)	(997)	(1,954)	(2,931)	(3,095)
Operating balance						
Preliminary Budget Update	7,999	3,455	5,056	3,970	3,163	3,133
Half Year Update	7,999	7,388	6,053	5,924	6,094	6,228
	-	(3,933)	(997)	(1,954)	(2,931)	(3,095)
Residual cash						
Preliminary Budget Update	2,653	840	(2,881)	(2,990)	(3,757)	(3,756)
Half Year Update	2,653	759	(763)	(779)	(851)	(937)
	-	81	(2,118)	(2,211)	(2,906)	(2,819)
Net core Crown debt						
Preliminary Budget Update	4,411	1,834	3,761	5,944	8,908	11,999
Half Year Update	4,411	1,983	1,756	1,705	1,792	2,105
	-	149	(2,005)	(4,239)	(7,116)	(9,894)
Net core Crown debt - % of GDP						
Preliminary Budget Update	*2.6%*	*1.0%*	*2.0%*	*3.1%*	*4.4%*	*5.6%*
Half Year Update	*2.6%*	*1.1%*	*0.9%*	*0.9%*	*0.9%*	*1.0%*
Gross sovereign issued debt (excl RBSC)						
Preliminary Budget Update	30,890	31,940	32,603	33,104	37,639	37,987
Half Year Update	30,890	33,303	33,034	31,779	34,566	*33,172*
	-	1,363	431	(1,325)	(3,073)	(4,815)
Gross sovereign issued debt (excl RBSC) - % of GDP						
Preliminary Budget Update	*18.5%*	*17.7%*	*17.6%*	*17.2%*	*18.6%*	*17.9%*
Half Year Update	*18.5%*	*18.7%*	*17.7%*	*16.3%*	*17.0%*	*15.6%*

If the potential downside risks to Treasury's economic forecasts were to eventuate, this would lead to a deterioration of the forecast fiscal position above.

Background

In May 2007, FYO Ministers agreed the following priorities for Budget 2008:

- Early years (giving our children the best start in life);
- Eliminating family violence; and
- Effective interventions in the justice sector

In September 2007, FYO Ministers added two priorities:

- Realising youth potential; and
- Developing the NGO sector ('Pathways to Partnership').

Bids submitted against FYO

The bids submitted against the FYO categories in December 2007 are shown in the table below. In February 2008, and prior to the first meeting of FYO Ministers, Cabinet agreed to fund the NGO sector at a level higher than the bid submitted in December.

FYO categories	Operating $millions				
	2007/08	2008/09	2009/10	2010/11	2011/12
Confidence and supply	-	50	51	52	53
Wages	-	203	215	227	228
Key business and service delivery failure	24	506	633	691	755
Developing the NGO sector	-	34	64	84	104
Early years	-	22	37	51	61
Effective interventions	-	17	23	30	43
Eliminating family violence	-	8	13	16	16
Realising youth potential	-	56	105	115	117
Other	-	73	168	187	239
TOTAL	**24**	**969**	**1,309**	**1,453**	**1,616**

FYO Ministers have worked towards an indicative allocation of $520 million per annum.

Rather than use a hierarchy to prioritise bids, Ministers considered priorities across the bids lodged giving them the ability to consider the opportunities and trade-offs between the different FYO categories.

Key features of the proposed package

The package developed by FYO Ministers is outlined in the Annex A. The package significantly advances one of the key FYO priorities: developing the NGO sector. Through this priority, progress will also be made on the four other FYO priorities: eliminating family violence; early years; realising youth potential; and effective interventions. In total, 35% of the package will be used to advance the FYO priorities.

Within the 35% directed to priorities, 13% advances key Government manifesto commitments in the education sector – reducing the teacher-student ratio to 1-15 for new entrants from 2009, as well as the annual adjustment for the Government's policy in early childhood education. Government priorities in housing will also be advanced in this package (Hobsonville, shared equity home ownership pilot, and the Government commitment to improve social housing in Wellington).

The rest of the package is comprised of the Government's confidence and supply agreement with NZ First (the third tranche of the 1,250 additional police), the second tranche of the teachers' and principals' wage settlement, and some key business risks in the education, housing, social services and justice sectors. Education initiatives combined account for 56% of the package across the four years.

As a result of the high out-year costs of the NGO bid ($193 million) and the teachers' and principals' wage settlement ($155 million) the FYO package rises sharply to $520 million in 2011/12 but is underspent in earlier years.

Key business risks that remain outside the package

Despite scaling bids heavily so that as many business risks as possible could be funded, a number of significant risks remain outside the package, including:

> *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Options for managing the key risks

FYO Ministers have identified the most significant pressures that could be addressed if an additional $30 million were available over and above the $520 million allocation in 2011/12. These bids are listed in the orange section of Annex A and include the most critical youth justice and justice sector pressures, and a minimum cost proposal to address the Government's manifesto commitment for grandparents raising grandchildren.

Notwithstanding these bids, a number of key business risks and ministerial priorities will remain unfunded, and require departments to reprioritise accordingly. The most critical are included in the annex. Ministers will need to ask their departments to report back to them on how these pressures will be managed. *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

FYO Ministers have also identified a number of bids that could be funded for one or two years only, subject to a review of the programme and report-back to Cabinet. Should ministers wish to fund bids on a time-limited basis, they could be accommodated within the core $520 million package. Funding bids on a time-limited basis means that Ministers would need to fund the outyear funding from future budgets, and/or reconfigure or end the existing programmes once the time limited funding ceases.

Economic Transformation

Priorities

In March 2006 the Government agreed that the focus of its economic policy over the next decade would be on transforming New Zealand to a high income, knowledge based market economy that was both innovative and creative, and provided a unique quality of life to all New Zealanders. Cabinet also agreed to five sub-themes under which its Economic Transformation agenda would be progressed:

i Innovative and Productive Workplaces;

ii Globally Competitive Firms;

iii World Class Infrastructure;

iv Auckland – World Class City; and

v Environmental Sustainability.

In October 2007, Cabinet further refined the policy by focussing it in three priority areas – raising productivity, capturing opportunities arising out of strong and growing pressure for environmental sustainability, and taking advantage of an increasingly integrated global economy. Specifically, Cabinet agreed to advance its Economic Transformation agenda by concentrating its effort and resources on six Areas of Focus:

i Improving access to quality, fast reliable broadband services;

ii Smart and innovative responses to environmental issues;

iii Developing workplace skills, focusing on literacy and numeracy;

iv Supporting business internationalisation;

v Focusing government investment in areas of New Zealand's strengths; and

vi Making Auckland a world-class hub of innovation and internationalisation.

These priorities are being pursued through non-fiscal as well as fiscal measures (for example, the Royal Commission on Auckland's governance). In fiscal terms, Budget 2008 makes credible progress across all five Economic Transformation sub-themes, with proposed new spending of $1.6 billion over four years plus $1.2 billion capital. Within the Economic Transformation budget theme this year, it is clear that the predominant focus is on innovation and skills, which accounts for approximately 70% of all proposed Economic Transformation expenditure ($1.1 billion over four years plus $979 million capital).

Highlights of proposed package

Highlights of the proposed Economic Transformation budget package include:

- **Innovation:** The Fast Forward fund will provide funding to transform New Zealand's pastoral and food industry via targeted investments with matching industry support (*$700 million capital*). Fast Forward will directly address three of the six Areas of Focus agreed by Cabinet in October 2007. The New Knowledge initiative is a significant new research package aligned to Economic Transformation priorities, including skills and capability that underpin innovation (*$200 million over four years*);

- **Skills:** The Skills Package targets workforce literacy, language and numeracy needs (*$166 million over four years*). Funding for tertiary education and student support initiatives will make tertiary education and skills training more accessible and affordable to a wider group of people (*$359 million over 4 years plus $169 million capital*);

- **Infrastructure:** The broadband package is expected to provide contestable funding for fibre loops and contribute to building a second international cable (*quantum under consideration by Ministers*). Additional investment will be provided to maintain and upgrade the rail network (*$28 million in 2008/09 plus $90 million capital*). Together, these investments will improve the flow of goods and services, and links between people and firms, both within New Zealand and with the rest of the world, in an environmentally sustainable manner; and

- **International Connections:** New Zealand's linkages with the world will be strengthened by significant investment in government resources to secure and support increased market access for New Zealand firms, coupled with extra funding for Globally Competitive Firms to give effect to recently-agreed business internationalisation policies (*$166 million over four years*). The package also includes funding for New Zealand's participation at the 2010 Expo in Shanghai.

Two significant matters remain to be resolved before the Economic Transformation theme in Budget 2008 is finalised:

- **Broadband:** Ministers are still considering a range of options for increased investment in broadband. No firm decisions on quantum or the activities to be undertaken have been reached.
- **Rail:** Negotiations are continuing with Toll Holdings concerning the potential purchase by Government of the rail network.

Decisions on these matters will increase expenditure on Economic Transformation in Budget 2008 to greater or lesser extents.

In terms of Annexes B and C to this report, the process around ET-Other has identified marginal bids which are just above, or below, threshold criteria set for this package. Hon Hodgson's process for the ET-Innovation package has concluded with a balanced package which meets his objectives, with no bids being identified as marginal.

National Identity

Summary of proposed package

The proposed National Identity package, which at this stage has not had significant Ministerial involvement:

i **Preserves and enhances heritage tourism potential** (Re-erecting Mataatua Whare, Kerikeri Basin, Antarctic Heritage Trust, maintenance of Historic Places properties, supporting a well-functioning Department of Conservation);

ii **Ensures New Zealand maintains a diverse, vibrant music industry** (NZ Music Commission and New Zealand Symphony Orchestra);

Provides support for agencies to make the most of legislative changes under consideration by Parliament so assets and resources can be fully utilised (*[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]* and Maori Trustee Office); and

iii **Enables agencies to manage and maintain key documents and other source material** so they are accessible now and in the future (National Archives, Te Mangai Paho, Maori Land Court, National Library).

Issues to consider when looking at the composition of the package

1. For the following high-priority initiatives included in the package, the **level of funding required to achieve Ministerial objectives could be reconsidered** to make room in the package for more new proposals:

   i Re-erecting Mataatua Whare and Related Facilities (currently $5 million);

   ii Establishing a Wharewaka for the Wellington Waterfront (currently $5 million); and

   iii Progressing a Historic Heritage Site of National Symbolic Importance: Kerikeri Basin (currently $10 million over four years).

2. The following marginal initiatives included within the package are about **maintaining existing services or meeting current demands** to ensure continued service delivery:

   i Ensuring Adequate Storage for Archives (to assess storage options);

   ii Building a National Library for the 21st Century (to meet critical storage requirements but not enhance services – lowest-cost option with no significant enhancement to services);

   iii Maintain Radio New Zealand’s Core Services (lowest-cost option included);

iv NZ Music Commission – Domestic and International Market Development (existing services only, no funding could mean this organisation would have to cease);

v New Zealand Symphony Orchestra – Maintaining Current Services;

vi New Zealand Historic Places Trust Operational Capability Funding (to undertake essential property maintenance only);

vii Funding to extend the New Zealand Police Deployment to Timor-Leste until 30 June 2009 (assuming balance comes from ODA budget); and

viii Drug Free Sport New Zealand administrative capability.

3. There are a number of **marginal proposals for new activities currently outside the package**:

i *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

ii Te Papa Cost of Services and Capability ($1.46 million to meet one-off cost pressures in 2008/09 until a review of long-term funding and use of reserves can be completed);

iii Contestable Community Biodiversity Fund ($2 million pilot funding for two years);

iv *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*;

v Ocean Survey 20/20 (OS 20/20) Programme ($5.58 million and exceeds amount remaining in package);

vi A staged expansion of the Maori Wardens initiative to 14 regions from the six regions included in the High Priority initiatives section using the lowest cost expansion option ($4.776 million over four years and exceeds the amount remaining in the package); and

vii Building a National Library for the 21st Century – enhancements on top of the critical additional storage element already included (an additional $11.848 million over four years and exceeds amount remaining in package).

Other

Description of the proposed package

The "Other" allocation is set up to cover votes that do not fit neatly within themes. The "Other" allocation this year covers Hon Peter Dunne's Vote Revenue and Rt Hon Winston Peters' Votes Official Development Assistance and Racing. (Note that funding for Vote Foreign Affairs and Trade is being treated as a pre-commitment, and as such does not impact on a specific theme.) For communication purposes, these initiatives will be included in relevant themes, where appropriate.

How to balance the package

The indicative "Other" allocation is $100 million per annum. The package proposed in this paper is $124 million per annum in outyears, compared to the approximately $235 million submitted by Ministers. "Other" is overspent by $167 million in 2007/08, largely driven by one-off funding for Eden Park of $165 million.

The proposed package covers both service delivery risks and a range of ministerial priorities. Should Ministers wish to balance the "Other" package, one or more of the following discretionary initiatives could be removed:

- Enhancing the SuperGold Card ($22.5 million ongoing);
- School Operations Grant: 1.9% on top of the amounts included in the FYO package ($18.6 million ongoing);
- Optimising Central Government Investment in Local Government – Rates Rebate Scheme ($13.2 million ongoing);
- People Capability Remuneration for IRD ($5 million ongoing); and
- New Zealand Farms OnLine ($4.5 million ongoing).

In addition to these initiatives, the package is largely made up of initiatives for KiwiSaver implementation, Parliamentary Service, Office of the Clerk and Communications Security and Intelligence initiatives. Further detail is provided in Annex E.

Overview of proposed package

The proposed Vote Health Budget package for Budget 2008 focuses on meeting key pressures and advancing the following priority areas: actioning the agenda for quality, strengthening health services we can trust, investing in early years and youth potential, improving the determinants of health and investing in wellness.

The most significant Health initiative is the annual inflationary adjustment (Forecast Funding Track and Demographics) of $496 million. This initiative seeks to maintain current public health service coverage and respond to demographic and technological change in the health sector. Despite the considerable funding provisions through FFT and Demo, DHBs are facing significant pressure from potentially high cost IR settlements. The Health package also contains $65 million for sector risk management. Treasury considers this to be a prudent risk provisioning given known pressures.

Operating $ millions	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2011/12**	**Outyears**	**4 Year Totals**
Vote Health Budget 2008 allocation		**750.0**	**750.0**	**750.0**	**750.0**	**750.0**	3,000.0
Additional revenue from baselines and ACC Public Health Acute Services	11.1	127.1	128.8	88.3	75.5	63.9	419.7
Total funding available for Vote Health Budget 2008	**11.1**	**877.1**	**878.8**	**838.3**	**825.5**	**813.9**	**3,419.7**
Proposed Vote Health Operating Package							
Actioning the agenda for quality	6.0	66.4	69.2	70.3	70.3	70.3	276.2
Strengthening health services we can trust	1.0	637.3	633.1	627.1	627.1	627.1	2,524.8
Investing in early years and youth potential	3.0	78.6	85.7	89.0	86.3	73.4	339.6
Improving the determinants of Health	1.2	42.0	38.5	4.3	4.5	4.5	89.3
Investing in wellness		52.8	53.3	53.2	53.2	53.2	212.6
Total spending supported within the package	**11.1**	**877.1**	**879.8**	**844.1**	**841.5**	**828.5**	**3,442.5**
Surplus/(Precommitment) required	**-**	**-**	**(1.0)**	**(5.7)**	**(16.0)**	**(14.7)**	**(22.7)**

The proposed package exceeds the Health allocation in outyears and will require a precommitment against Budget 2009 of $14.7 million in outyears. The Minister of Finance agreed to allow modest precommitments of up to $36 million where they are necessary for progressing high value initiatives and provisioning for Health sector risks.

Operating package

$3.442 billion has been allocated to the Minister of Health's priority areas over the next four years. The package proposes spending $276 million (four year totals) on actioning the agenda for quality, $2.5 billion on strengthening health services we can trust, $340 million investing in early years and youth potential, $89 million for improving the determinants of health and $213 million on investing in wellness.

The proposed Vote Health operating package also contributes to a number of cross-government initiatives. The package includes $30 million over four years for Healthy Housing to improve living environments to reduce the risk of infectious diseases. *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials.]* $8.397 million over four years will go to Vote Education for education services to support the universal newborn screening service.

Capital Package

The Minister of Health seeks *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]* to enable greater flexibility to respond to identified sector capital development pressures. Treasury's view is that a capital allocation of $50 million is sufficient given wider government capital priorities, the current uncertainties about Health capital pressures and existing Health capital resources ($114 million capital and up to $93 million potential underspend transfers). Senior Ministers are asked to confirm the capital allocation for Health in this paper.

Options for reprioritising the Health package in light of wider Government priorities

Given considerable pressure on the Budget across all themes, Ministers may wish to consider whether these lower priority initiatives should be supported in full or in part, or deferred:

[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

Capital

Description of the proposed package

Most of the proposed capital package this year is directed towards initiatives in Agriculture and Forestry, Foreign Affairs, Education (both compulsory and tertiary), Rail, Corrections, Transport, National Library and Government House. The package covers initiatives previously agreed by Ministers, essential service delivery risk areas and a small number of other Ministerial priorities. Of particular interest, given their size, are the following initiatives:

i Pastoral and Food Innovation Fund ($700 million);

ii Hobsonville: Urban Development ($33 million);

iii Foreign Affairs initiatives ($65 million);

iv Increasing the Student Loan Scheme living cost component by 10% and ongoing CPI adjustments ($175 million);

v Mt Eden Replacement ($117 million);

vi ONTRACK funding ($90 million);

vii Building a National Library for the 21st Century ($51 million, though as mentioned on page 4, the associated operating funding for the full building redevelopment option has not been included within the proposed National Identity package);

viii Health Capital Envelope (Treasury recommends funding of $50 million, which is the figure included within the proposed package; the Minister of Health seeks *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*);

ix 2009 School Staffing Improvements for New Entrants ($33 million);

x Canterbury Transport Project and Regional Development Transport Funding ($64 million);

xi *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*;

xii Refurbishment of Government House Wellington ($47 million);

xiii 2008/09 School Property Business Case ($75 million); and

xiv Tertiary Education Capital Investment Fund ($95 million).

Once a between-budget contingency of $100 million is factored in, the proposed package totals $2.2 billion, $389 million higher than the allowance agreed at Budget Strategy.

Options for reducing the overspend of the package

If Ministers wished to reduce the size of the proposed capital package, Treasury's recommendation from a fiscal perspective would be to scale the following items:

i **Scale new loan funding to ONTRACK to $25 million.** ONTRACK has a history of significant underspends, and there is a high risk that ONTRACK will be unable to spend the full amount proposed in Budget 2008. In Treasury's view, $25 million would allow ONTRACK to continue operating as they have been in recent years. **($65 million saving)**

ii **Increase the Student Loan Scheme living cost component by 10% one-off** (part of the 'Student Support' set of initiatives)**.** This would cost $100 million in total, with ongoing CPI adjustments being able to be considered in future budgets. (**$75 million saving**)

iii **Limit the additional funding for the Tertiary Education Capital Investment Fund to $65 million.** When added to funding already in contingency, this would result in a Fund of approximately $95 million. (**$30 million saving**)

iv **Do not support funding for the Canterbury Transport Project and Regional Development Transport funding.** Both these initiatives can be funded through alternate sources – Regional Fuel Tax and the National Land Transport Fund. (**$64 million saving**)