THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Budget 2008: Bilateral for Vote Education (tertiary), Research Science and Technology and Economic Industry and Regional development

Date:	22 February 2008	**Report No:**	T2008/233

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Dr Michael Cullen)	**Read** before the Bilateral with Hon Pete Hodgson	Before 12.45pm on Tuesday 26th February 2008
Associate Minister of Finance (Hon Trevor Mallard)	**Read** before the Bilateral with Hon Pete Hodgson	Before 12.45pm on Tuesday 26th February 2008

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Simon Macpherson	Manager, Workforce Attachment and Skills	*[deleted – privacy]*	✓
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Minister of Finance's Office Actions (if required)

None.

Enclosure: **Yes**

Treasury Report: Budget 2008: Bilateral for Tertiary Education and Votes Research Science and Technology, and Economic, Industry and Regional development

Attached is a briefing for the bilateral between the Minister of Finance and Hon Pete Hodgson at 12.45 p.m. on Tuesday 26 February 2008 to discuss the budget initiatives for tertiary education (including student support initiatives in Votes Social Development and Revenue), as well as for Votes Research Science and Technology and Economic, Industry and Regional Development.

The bilateral briefing is structured as follows:

We expect the key issues for discussion will be:

- *Tertiary Capital Fund* – Treasury supports a scaled capital fund of $65 million over two years (plus the remaining balance of $20 - 30 million in existing capital contingencies) to establish the fund. This will be adequate to establish the fund in the short term, but further funding will need to be considered in future budgets.

- *Increasing the Student Loan Scheme Living Cost Component* – Treasury supports scaled capital funding of $21 million for a one-off CPI adjustment to the component. This is a small adjustment, but will signal the government's willingness to address the issue and further increases can be considered in subsequent budgets.

Recommended Action

We recommend that you **read** the attached briefing and use it as the basis for making decisions in your bilateral with Hon Pete Hodgson at 12.45 p.m. on Tuesday 26 February 2008.

Simon Macpherson
Manager, Workforce Attachment and Skills
for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

Recommendations

TERTIARY EDUCATION (INCLUDING STUDENT SUPPORT)

Contested Initiatives

a Tertiary Education Capital Investment Fund **analysis p. 9**

- Education Agencies seek to create a new fund of $220 million over the forecast period (plus $60 million beyond the forecast period and also other capital funding already in contingency) to support capital projects at tertiary education institutions.

Treasury View

- Treasury supports the creation of the fund at a scaled level of $65 million over two years. Although the creation of the fund will improve the quality of decision-making on tertiary sector capital expenditure, the current initiative is too large to be managed within the capital allocation. Given that the remaining balance of existing capital contingencies will be in the region of $20 - $30 million at the end of 2007/08, $65 million over two fiscal years should be adequate to establish the fund in the short term, although further funding will need to be sought in future budgets.
- Treasury's assessment is based largely on fiscal considerations, and we agree with Education agencies that it would be preferable to establish the fund over a longer timeframe. Should you wish to set aside more funding for this initiative, you could consider another $30 million in 2010/11.

Education Agencies' View

- Education officials consider that a fund lasting two years is not likely to support the strategic approach desired by Cabinet when it decided to establish the fund in September 2007. A fund at the level proposed by Treasury would only be sufficient to manage viability risks and a very limited amount of strategic investment.

	$million - increase/(decrease)				
Capital (GST excl)	*2007/08*	*2008/09*	*2009/10*	*2010/11*	*2011/12*
Department	-	40.000	60.000	60.000	60.000
Treasury	-	35.000	30.000	-	-
Treasury – alternative scaled option	-	35.000	30.000	30.000	-

b Increasing the Student Loan Scheme living cost component by 10 percent

analysis p. 10

- Education agencies seek capital funding of $176 million over the forecast period (with associated operating funding) to increase the $150 per week student loan living cost entitlement by 10 percent from 1 January 2009, and then to adjust the entitlement annually for inflation, with the first CPI adjustment on 1 April 2009.

Treasury View

- Treasury recommends that you support scaled capital funding of $21 million. We consider that there is a case for a substantial increase to the living cost component, but our recommended option – driven by fiscal considerations – is for a one-off CPI adjustment only in Budget 08. This option will maintain rather than restore the real value of the component, but it will signal the government's willingness to address the issue, and further increases can be considered in subsequent budgets.

Education Agencies' View

- Education agencies recommend that you do not scale the initiative. The living cost borrowing entitlement has remained unchanged for over a decade, and its value has eroded considerably. Given the period over which the entitlement has not been adjusted, Treasury's scaled option risks being seen by students as derisory.

	$million - increase/(decrease)				
Capital (GST excl)	*2007/08*	*2008/09*	*2009/10*	*2010/11*	*2011/12 & Outyears*
Department	-	17.967	43.284	52.797	61.729
Treasury	-	3.020	6.386	6.094	5.760

Initiatives supported by the Treasury and Education Agencies

c Student Achievement Component: Access in Priority Areas **analysis p. 10**

- Education Agencies seek $15 million in capital over the forecast period (with associated operating funding) to fund the student loan impact of increased enrolments at Universities and Institutes of Technology and Polytechnics (ITPs).
- This initiative provides for a minimum level of growth in tertiary participation, so declining to fund the initiative would potentially reduce student access to tertiary education.
- Treasury and Education Agencies recommend that you support the initiative on the basis that measures to maintain access for domestic students should take precedence in the tertiary package.

	$million - increase/(decrease)				
	2007/08	*2008/09*	*2009/10*	*2010/11*	*2011/12 & Outyears*
Capital (GST excl)	-	6.726	8.499	6.044	(5.791)

d Increasing the student allowance parental income threshold by 10 percent

analysis p. 11

- Education Agencies seek to increase the student allowance parental income threshold by 10% to approximately $50,172 from 1 January 2009. The increase in the allowance threshold will result in lower drawdowns of student loans, so the bid generates capital savings.

- Treasury and Education Agencies recommend that you support the initiative, on the basis that the initiative is essentially an operating bid, and the Minister for Tertiary Education has the freedom to fund his own priorities within the operating expenditure set aside for the Innovation Allocation. The small capital savings resulting from this initiative will relieve some of the pressure on the capital allocation.

	$million - increase/(decrease)				
	2007/08	*2008/09*	*2009/10*	*2010/11*	*2011/12 & Outyears*
Capital (GST excl)	-	(1.008)	(2.130)	(2.075)	(2.009)

e Expansion of Bonded Merit Scholarship Scheme **analysis p. 11**

- Education Agencies seek to expand the number of bonded merit scholarships offered annually from 1,000 to 1,500 from 2009. The increase in the number of scholarships will result in lower drawdowns of student loans, so the bid generates capital savings. This initiative fulfils a 2005 Labour Party Manifesto commitment.
- Treasury and Education Agencies support the initiative on the basis that it fulfils a Manifesto commitment. The small capital savings resulting from this initiative will relieve some of the pressure on the capital allocation.

	$million - increase/(decrease)				
	2007/08	*2008/09*	*2009/10*	*2010/11*	*2011/12 & Outyears*
Capital (GST excl)	-	(0.399)	(0.777)	(1.131)	(1.221)

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VOTE ECONOMIC, INDUSTRY AND REGIONAL DEVELOPMENT

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i Standardised Business Reporting **analysis p. 14**

MED view

- MED proposes that there be a capital contingency for 2008/09 of $3 million. The capital would be contingent on an April Cabinet report back on this work, and the operating costs needed to support this work being found from within existing baselines in Vote E, IRD and Ministers agreeing to any re-prioritisation.

Treasury view

- Treasury's view is that this initiative should be deferred. At present there is no detailed business case to support this initiative and the cost puts it outside fiscal parameters given higher priorities.

	$million - increase/(decrease)				
	2007/08	*2008/09*	*2009/10*	*2010/11*	*2011/12 & Outyears*
Capital (GST excl)					
Department	-	3.000	-	-	-
Treasury	-	-	-	-	-

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VOTE RESEARCH, SCIENCE AND TECHNOLOGY

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Tertiary Education – Analysis

Analysis of Initiatives

1. Capital funding is being sought for tertiary education initiatives in Votes Education, Social Development and Revenue through this bilateral. The associated operating funding will be sought through Theme – Economic Transformation, as set out below:

	$million - increase/(decrease)				
	2007/08	*2008/09*	*2009/10*	*2010/11*	*2011/12*
Capital sought at this bilateral	-	63.286	108.876	115.635	112.708
Operating associated with this capital – to be sought through ET Theme	-	17.432	34.446	37.067	33.391

Contested Initiatives

Tertiary Education Capital Investment Fund *(recommendation a)*

2. Education Agencies seek to create a new fund of $220 million over the forecast period (plus $60 million beyond the forecast period and also other capital funding already in contingency) to support capital projects at tertiary education institutions.

Treasury View

3. Treasury supports the creation of the fund at a scaled level of $65 million over two years. Although we recognise that the creation of the fund will improve the quality of decision-making on tertiary sector capital expenditure, the current initiative is too large to be managed within the capital allocation. Given that the remaining balance of existing capital contingencies will be in the region of $20-$30 million at the end of 2007/08, we believe that $65 million over two fiscal years would be adequate to establish the fund in the short term, with the proviso that further funding would need to be sought in future budgets.

4. Treasury's assessment is based largely on fiscal considerations, and we agree with Education agencies that it would be preferable to establish the fund over a longer timeframe to encourage institutions to assess their capital requirements over a longer term planning horizon. Should you wish to set aside more funding for this initiative, you could consider another $30 million in 2010/11.

Education Agencies' View

5. In September 2007 Cabinet agreed to establish a Capital Fund to enable a more strategic approach to be taken to larger capital projects and viability funding from tertiary education institutions. Education officials' best estimate is that a fund of $300 million over five years will best deliver upon this intention. A fund only lasting two years is not likely to support the strategic approach required in the tertiary sector, which has longer-term planning horizons. A fund at the level proposed by the Treasury would be sufficient to manage viability risks and a very limited amount of strategic investment.

Increasing the Student Loan Scheme living cost component by 10 percent *(recommendation b)*

6. Education agencies seek capital funding of $176 million over the forecast period (with associated operating funding) to increase the $150 per week student loan living cost entitlement by 10 percent from 1 January 2009, and then to adjust the entitlement annually for inflation, with the first CPI adjustment on 1 April 2009. This initiative impacts on Votes Social Development and Revenue.

7. Treasury recommends that you support the initiative at a scaled level of $21 million (with associated operating funding). Although we consider that there is a case for a substantial increase to the living cost component, our recommended option – driven largely by fiscal considerations – is for a one-off CPI adjustment only in Budget 08. This option will maintain rather than restore the real value of the component, but it will signal the government's willingness to address the issue, and further increases can be considered in subsequent budgets.

Initiatives supported by the Treasury and Education Agencies

Student Achievement Component: Access in Priority Areas *(recommendation c)*

8. Education Agencies seek $15 million in capital over the forecast period (with associated operating funding) to fund the student loan impact of increased enrolments at Universities and Institutes of Technology and Polytechnics (ITPs). This initiative impacts on Votes Social Development and Revenue in addition to Vote Education.

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11. The government could potentially decide to fund a smaller increase in enrolments, which would reduce the student loan impact and therefore the amount of capital required. The direct link between the number of enrolments and the impact of student loans means that it would be relatively straightforward to calculate the reduction in capital requirements. Given that the proportion of higher end qualifications in the workforce is strongly correlated with productivity increases (though not evenly across qualification types or industry sectors), however, officials consider that maintaining access to high level qualifications should be a priority. Officials therefore recommend that you do not scale the capital.

12. The only way to scale the capital *without* affecting participation rates in tertiary education would be to revisit the existing policy settings for the Student Loan Scheme. This option would need to be carefully considered, as it would represent a major change to the direction of government policy and could potentially prove counter-productive to the aims of this initiative in particular. Therefore, officials recommend that you do not pursue the option at this time.

13. Treasury and Education Agencies joint recommendation is that you support the initiative on the basis that measures to maintain access for domestic students should take precedence in the tertiary package.

Increasing the student allowance parental income threshold by 10 percent *(recommendation d)*

14. Education Agencies seek to increase the student allowance parental income threshold by 10% to approximately $50,172 from 1 January 2009. The increase in the allowance threshold will result in lower drawdowns of student loans, so the bid generates capital savings. This initiative impacts on Votes Social Development and Revenue.

15. Treasury and Education Agencies recommend that you support the initiative, on the basis that the initiative is essentially an operating bid, and the Minister for Tertiary Education has the freedom to fund his own priorities within the operating expenditure set aside for the Innovation Allocation. The small capital savings resulting from this initiative will relieve some of the pressure on the overall capital allocation.

Expansion of Bonded Merit Scholarship Scheme *(recommendation e)*

16. Education Agencies seek to expand the number of bonded merit scholarships offered annually from 1,000 to 1,500 from 2009. This initiative would fulfil a commitment in the 2005 Labour Party Manifesto. The increase in the number of scholarships will result in lower drawdowns of student loans, so the bid generates capital savings. The initiative impacts on Votes Social Development and Revenue.

17. Treasury and Education Agencies support the initiative on the basis that it fulfils a Manifesto commitment. The small capital savings resulting from this initiative will relieve some of the pressure on the overall capital allocation.

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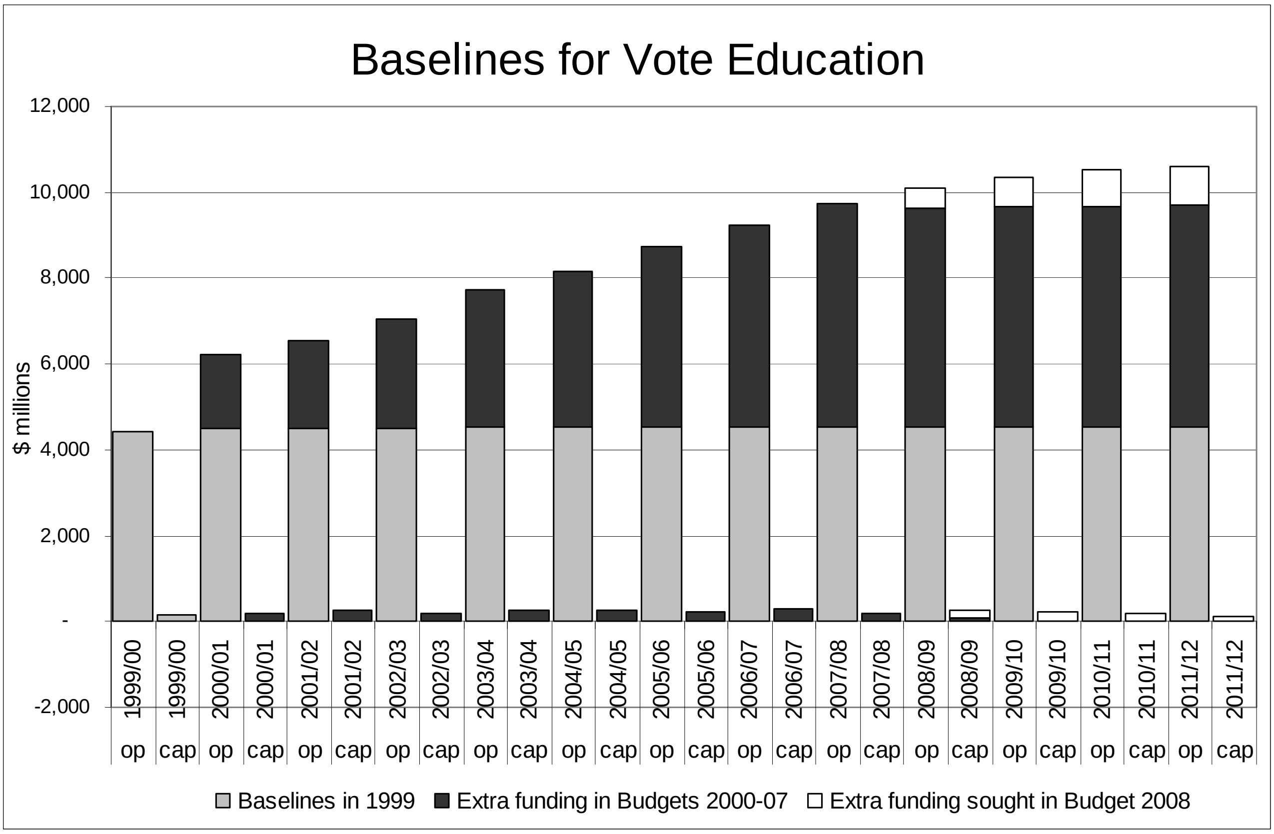
Analysis of Vote

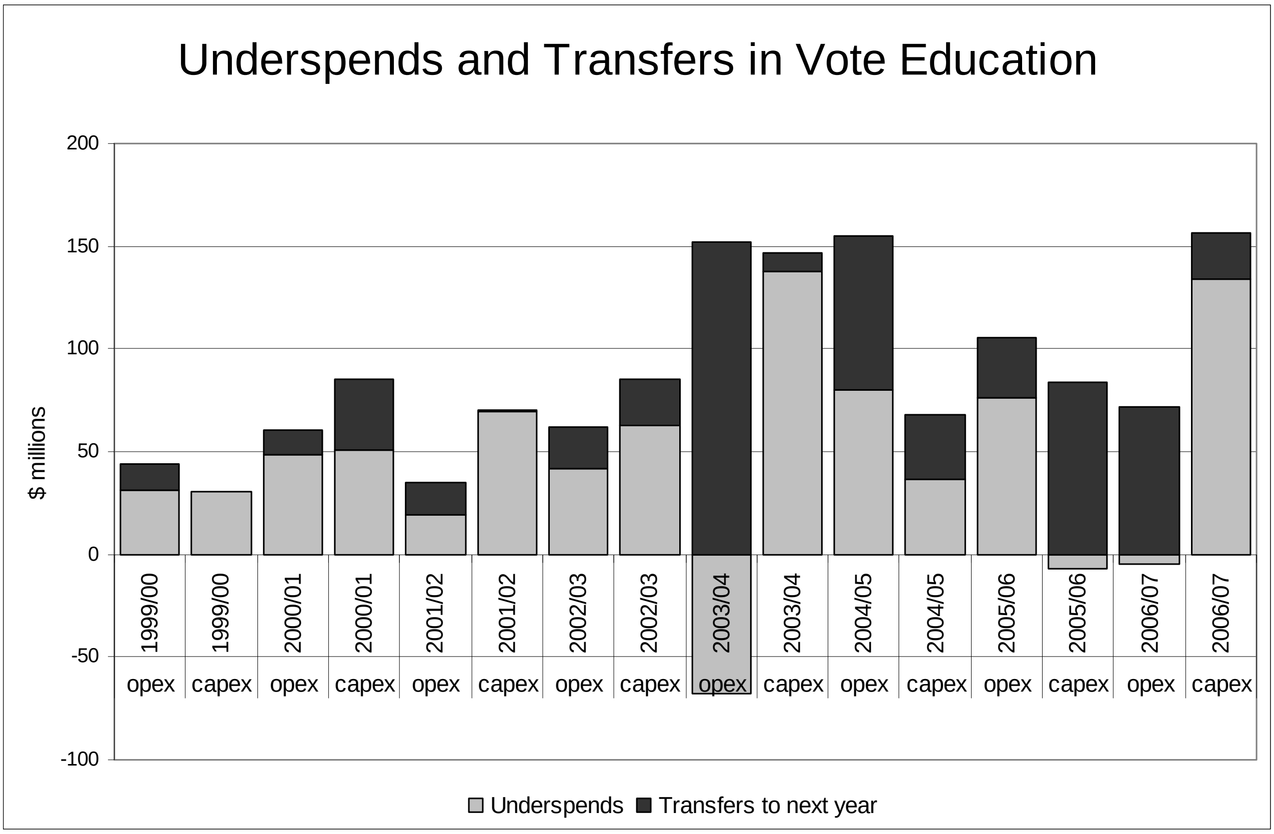
Baselines

21. Baselines for Vote Education (tertiary and non-tertiary) are shown in the graph below. The increase in baseline spending on education reflects the importance that successive governments have placed on improving the quality of education, as well as growth in student numbers in both the schooling and tertiary sectors, and increases in staff numbers and salary rates.



Underspends

A level of underspends is to be expected in a Vote of this size, but consistent underspends in certain areas can indicate that the level of resource committed to certain outputs is out of alignment with the ability to use that funding. The following graph below sets out the size of underspends and transfers in Vote Education (tertiary and non-tertiary):



22. Consistent and reasonably significant underspends have occurred in the following appropriations:

- Tertiary Education and Training (now split into a number of the new appropriations created to support the tertiary reforms)
- Training for Designated Groups
- Tertiary Scholarships

23. The underspends within the Tertiary Education and Training appropriation were in large part due to the instability of the demand-led Student Component fund. A new funding structure is in place from 1 January 2008, and it is too early to assess the likely level of underspends created by this new regime.

24. There have also been consistent delays to a number of capital appropriations, particularly relating to Partnerships for Excellence facilities and capital injections for tertiary institutions at risk.

Analysis of Initiatives

25. Funding is being sought for Vote Economic, Industry and Regional Development through this bilateral and also through themes Other-ET and ET-Innovation. This is summarised in the table below:

	$million - increase/(decrease)				
	2007/08	*2008/09*	*2009/10*	*2010/11*	*2011/12*
Capital sought at this bilateral	-	33.000	-	-	-
Operating associated with this capital – to be sought through ET Theme	-	9.535	-	-	-

26. Of the operating funding sought, $11 million relates to capital initiatives being discussed in this bilateral.

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Standard Business Reporting *(recommendation i)*

30. On 27 August 2007 Cabinet directed the Ministry of Economic Development (lead agency), Inland Revenue, Statistics New Zealand and ACC to report back to POL by 30 April 2008 with a Business Case for the implementation of Standardised Business Reporting (SBR) in New Zealand alongside the feasibility of establishing a Centralised

Information Repository (CAB Min (07) 31/10 refers). This bid included the requirements of Inland Revenue, Statistics, ACC and MED as the core SBR agencies.

31. SBR is a whole-of-government programme to reduce reporting burdens for business through eliminating unnecessary or duplicated reporting, and improving the interface between business and government agencies.

32. Treasury recommends that this initiative be deferred to Budget 09 because although there is considerable merit in the objective of reducing business compliance costs, there has been no business case developed yet, and the cost would likely put the initiative outside fiscal parameters given other higher priorities.

33. The original departmental costings for the initiative were $16 million operating and $42 million in capital. However, if Ministers would like to see progress on this initiative, Treasury and MED have developed an alternative, lower-cost, option.

		07/08	08/09	09/10	10/11	11/12	Total
Original Departmental Costings	Operating	-	5.050	5.600	3.700	2.150	16.500
	Capital	-	4.750	14.000	13.800	9.900	42.450
Alternative option	Operating	-	4.500	-	-	-	4.500
	Capital	-	3.000	-	-	-	3.000

34. The alternative option involves setting aside a tagged contingency for 2008/09 only. This would allow the project to progress in 2008/09, subject to Cabinet approval following the report back in April. It would enable Ministers to reassess the project at Budget 09 when there is more certainty around the costs of the project.

35. MED has indicated that the operational costs for this bid for 2008/09 are unlikely to be met from the Innovation allocation because of higher competing priorities. However, MED is currently looking at possible options to provide to Ministers for re-prioritisation of existing money within Vote E, IRD to be able to fund the operating component. MED believes that the capital contingency should be based not only on the Cabinet report back in April, but the operating costs needed to support this work being found from within existing baselines in Vote E, IRD and Ministers agreeing to any re-prioritisation.

36. Analysis indicates that the current New Zealand Business Portal (www.business.govt.nz) which was launched in 2007 and has received significant government investment could be strategically repositioned and its capabilities enhancement to form the basis for the Centralised Information Repository (CIR). Funding in 2008/2009 would enable this to take place alongside some early stage work for the introduction of SBR. MED believes that the CIR appears to have the most potential to deliver ‘quick wins’, with the implementation of SBR as a longer term strategy to deliver comprehensive benefits to business.

37. The details of the bid that was submitted in December were extrapolated from a number of sources including the Australian SBR business case, information obtained during the Quality Regulation Review and existing data available on the current cost of compliance in New Zealand and the cost savings to business realised by similar projects internationally. More detailed analysis of the potential costs and benefits of the implementation of SBR in New Zealand is currently being undertaken across agencies and will be available in the 30 April report back to Cabinet.

38. In August 2007, the Australian Treasurer announced the allocation of $235 million over the next three years to the implementation of Standard Business Reporting (SBR) in Australia. This was the result of a business case presented to the Australian

government which calculated that the implementation of Standard Business Reporting (General Ledger Cluster) would save Australian business in excess of $800 million a year from 2011. The newly elected Australian government have confirmed their commitment to this programme.

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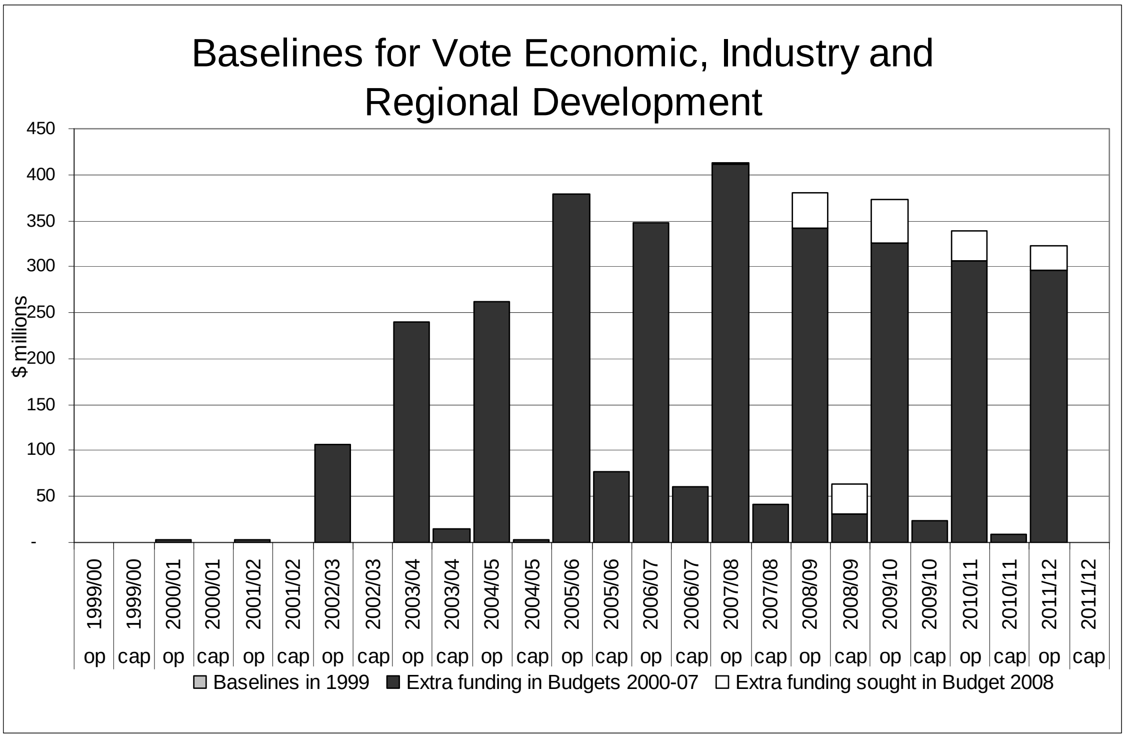
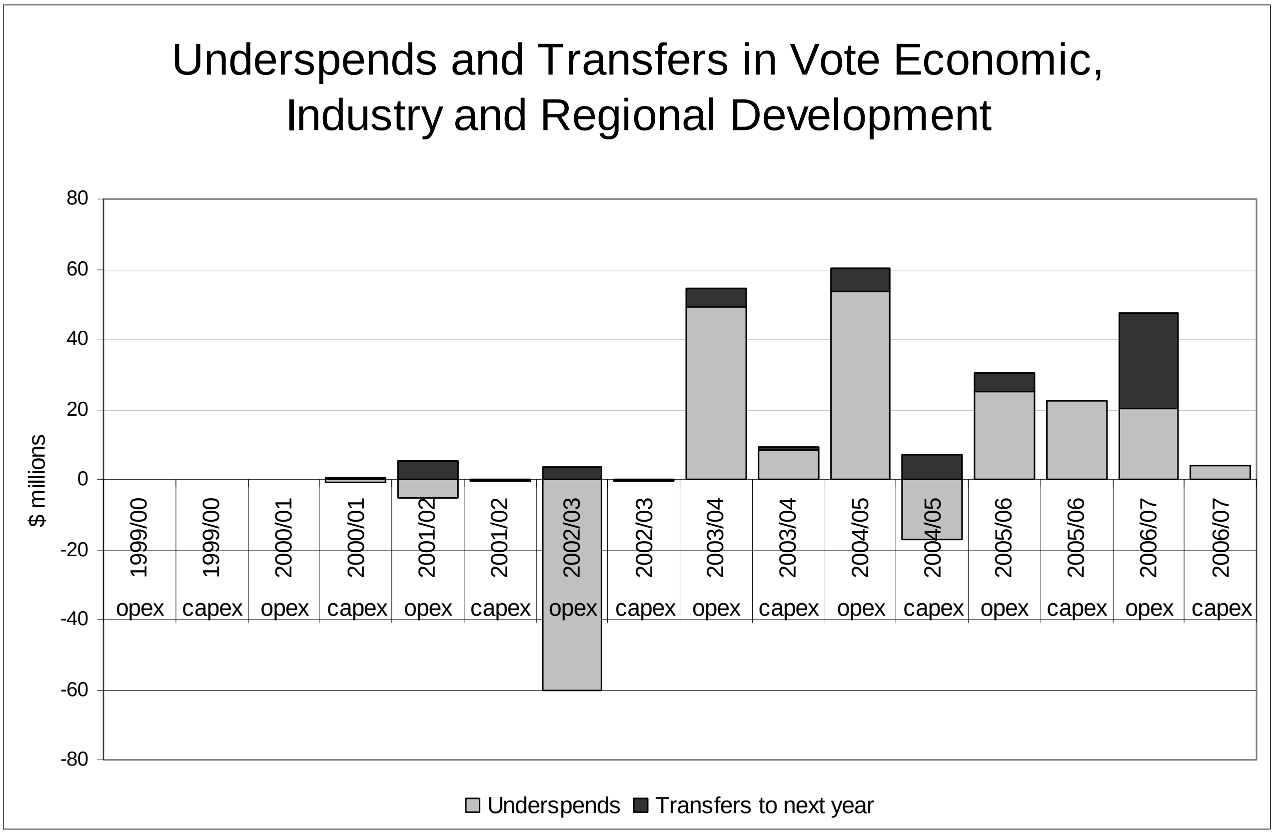
Analysis of Vote

50. Vote EI&RD baselines are shown in the graph below. The 2007/08 operating baseline is relatively high, primarily because of a one-off appropriation for the America's Cup ($36 million). There are also other time-limited programmes, notably the Buy Kiwi Made campaign and Major Events Development Fund.




Underspends and Transfers in Vote Economic, Industry and Regional Development
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$ millions
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Underspends
Transfers to next year

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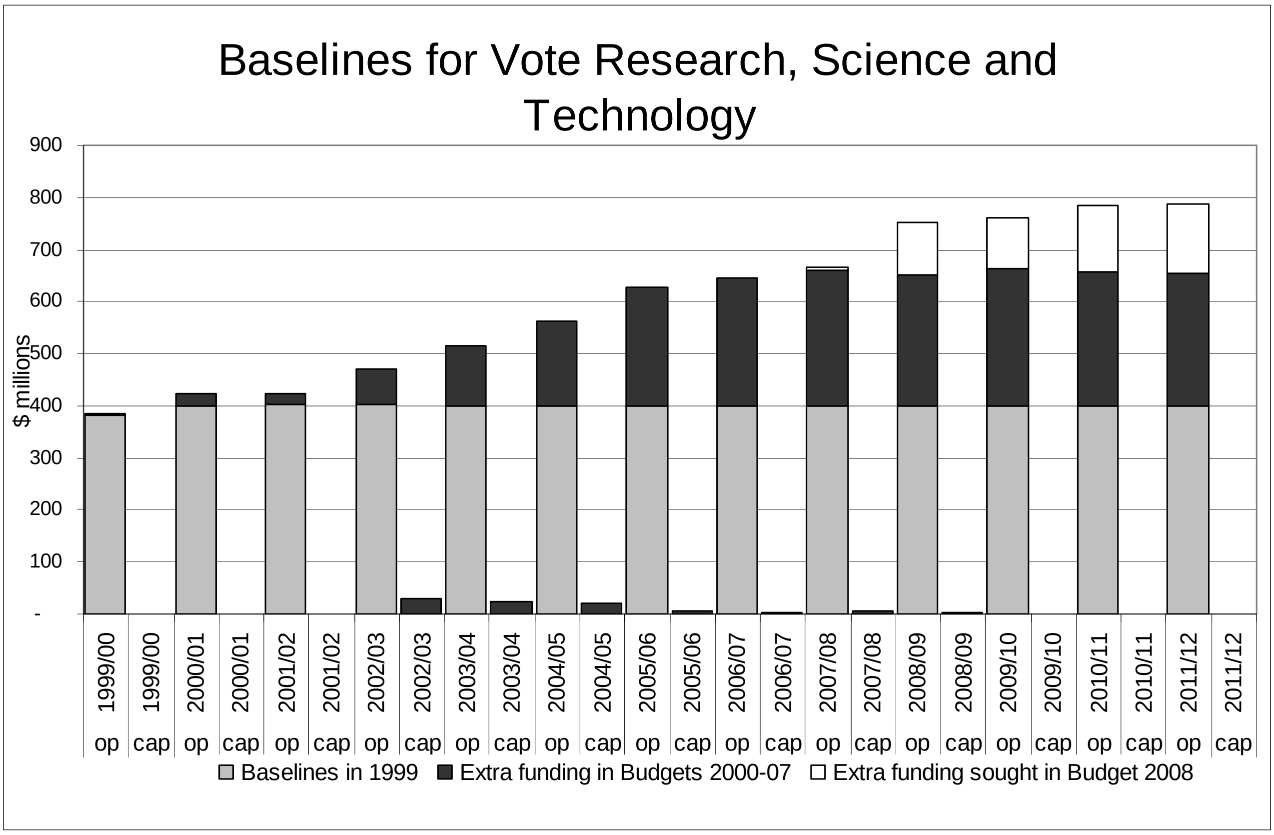
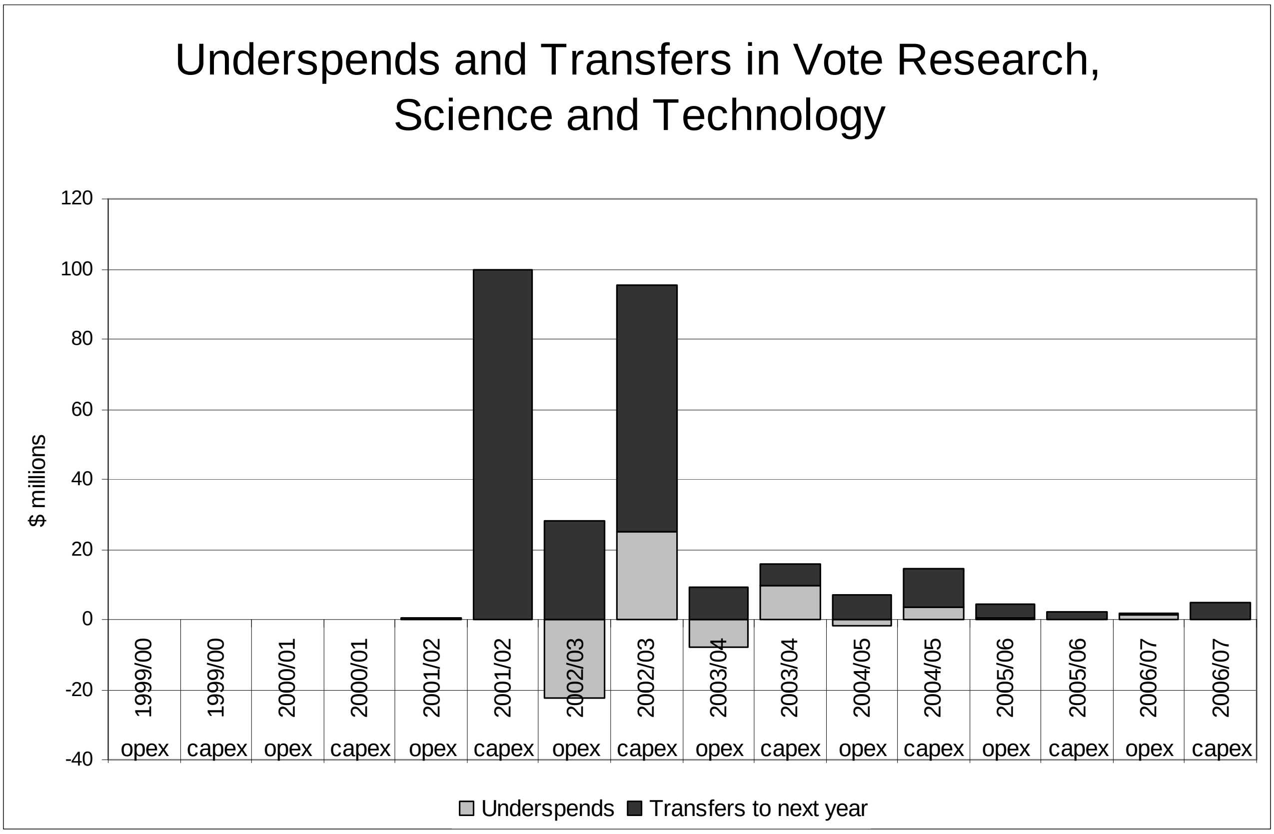
Analysis of Vote

57. Vote RS&T baselines and underspends are shown in the graphs below. There is only a small amount of capital in this vote.




Underspends and Transfers in Vote Research, Science and Technology
120
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Underspends
Transfers to next year

One-page Initiative Summaries

One-page summaries of the initiatives for discussion at this bilateral are attached on subsequent pages.