The Treasury

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[3] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

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

Vote: Finance

Vote: State Owned Enterprises

Vote: Crown Research Institutes

Four-year Budget Plan

Version [1]

1 December 2010

Submitted by:

Secretary to the Treasury
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Section 1: New Baseline and Summary of Changes

Introduction

This Four Year Budget Plan covers the three votes administered by the Treasury. These three votes have been considered together given their joint objectives, particularly around growing the New Zealand economy.

<u>*Direction of Change*</u>

New Zealand's economy has returned to growth after the global financial crisis and recession but the next five years will remain challenging. The Government is still borrowing large sums to pay for public services and welfare entitlements for New Zealanders in need. In the current uncertain environment, this means increasing vulnerability to potential global economic disturbances. Any government expenditure needs to contribute to growth and other vital social objectives. For the foreseeable future, the quality of services needs to be improved while constraining spending. Better management of capital and the Crown's balance sheet is critical to meeting these challenges.

Managing spending and capital well is one aspect of achieving higher, sustainable economic growth so New Zealanders can enjoy opportunities, jobs and higher incomes in this country.

The focus for the next four years will be to continue to address the six key drivers of economic performance, identified by Cabinet in June 2009, to provide the environment to achieve an ambitious step up of an average real GDP growth of 4 percent per capita over the medium term.

That environment needs to foster rapid growth in the tradable sector (exports) driving growth in the economy; increase the level and quality of investment leading to a lift in productivity and growth; and increase innovation enabling profitable entities to add higher value.

Treasury will build on the 2010 priorities which were designed to bed in policy to reinforce the recovery and lift longer term economic performance, thus closing the gap with Australia. It will assist the Government to create and cement in place policies so that the recovery results in an improvement in long-term economic performance.

Like all other State agencies, Treasury must do its work within tight financial constraints. In addition, Treasury has a role in supporting effective decision-making and management of the State sector. Treasury will focus its policy advice in the areas that will enable the Government to best deliver on current and future priorities.

The Government has a large number of priority areas where the Treasury will play a key role (refer next section). As the emphasis changes over time, Treasury will need to change the way it operates to ensure priorities are met within reducing baselines.

Treasury has aligned its focus to Government priorities, and will continue to do so through reprioritisation within its existing departmental baselines. This will require

Treasury to be a flexible organisation with broad capability that is able to support the government of the day while carrying out its day to day responsibilities.

As further work is undertaken over the coming months on putting into operation, the specific areas of responsibility associated with the priorities outlined in this Plan, reprioritising within existing appropriation and out year baseline may be required. These changes will be reflected in the March 2011 Baseline Update (MBU) or the October 2011 Baseline Update (OBU) as they are expected to be technical in nature.

Overall Impact

Operating	**Impact ($000s)**				
	2010/11	**2011/12**	**2012/13**	**2013/14**	**2014/15**
Current Baseline	*79,776*	*67,402*	*64,853*	*63,893*	*63,893*
Cost of new/increased activities					
Amount reprioritised	*(1,900)*	*1,900*			
New baseline	*77,876*	*69,302*	*64,853*	*63,893*	*63,893*

Capital	**Impact ($000s)**				
	2010/11	**2011/12**	**2012/13**	**2013/14**	**2014/15**
Capital proposals seeking new funding in Budget 2011.	*12,500*				
Capital proposals seeking decisions in Budget 2011 funded within baselines.					
Total capital intentions	*12,500*				

Section 2: Vote Priorities and Pressures

1. What you intend to achieve over the next four years (as outlined in the priorities letter agreed with the Prime Minister and as presented to ECC).

The economy is now growing, following its most severe recession in decades; however it is struggling to get going. It is likely to be some years before the output lost during the recession is regained. As a result the economy is some way from full employment and the economic and social benefits this would bring.

The global financial crisis highlighted our domestic vulnerabilities. The lessons learnt from the recent financial crisis include the importance of economic flexibility, a strong fiscal position, responsive monetary policy, a flexible exchange rate, flexible labour markets and a strong but flexible financial sector. New Zealand scores well on most of these dimensions but has deteriorated on some. In particular the fiscal position is no longer a source of strength.

In the short-term, the most important policy responses to this environment will require an active Treasury role. The first response is to carefully manage both capital and operating expenditure so that key services are delivered better at lower cost. The second response is to help support leadership of the public sector with Government and central agency colleagues so that these pressures are managed effectively.

At the same time, Treasury must work with Government to provide a business environment in which the New Zealand economy will converge with higher income countries and provide a future that will make our children and grandchildren choose to settle here. A significant increase in economic performance is necessary in order to meet the aspirations of New Zealanders and help meet wider objectives. To quantify this level of ambition, Treasury see the economy as being "on track" if it delivers an average real GDP growth of 4 percent per capita over the medium term.

Changing policy settings is central to achieving such a changed economic performance.

2. How these achievements link to the Government's priorities

The Treasury is Government's principal economic, financial and regulatory advisor. Our core job is to help the Government improve New Zealand's overall economic performance, and increase the living standards of New Zealanders, through the provision of high-quality advice and services. Our advice contributes to improved performance by making challenging issues more tractable to effective Government decision-making. The Treasury supports effective delivery of services by the State sector through its policy advice, and delivers some services directly where it is best placed to do so.

We perform three roles through these portfolios:

- Providing services directly, such as monitoring and managing the financial affairs of the Crown, including managing the Crown's debt through the New Zealand Debt Management Office (NZDMO), and supporting New Zealand's economic performance through the provision of services through the New

Zealand Export Credit Office (NZECO), Crown Wholesale Guarantee Facility and the Retail Deposit Guarantee Scheme.

- Raising the quality of advice and service delivery in the State sector, by leading improvements in State sector management and performance though a shared work programme involving the three Central Agencies: the Treasury, the DPMC and the SSC, and providing second-opinion advice on the economic and financial implications of other government agencies' proposals.
- Providing policy advice direct to Ministers to facilitate Government decisions on changes and initiatives that support better economic performance and higher living standards.

Treasury as the government's primary economic and financial advisor is central to identifying and helping give effect to desired policy changes to achieve economic growth. Treasury will focus on continuing to address the six key drivers of economic performance identified by Cabinet in June 2009:

1. Investing in productive infrastructure.
2. Removing red tape, improving regulation.
3. Supporting business innovation and trade.
4. Improving education, lifting skills.
5. Lifting productivity and improving services in the public sector.
6. Strengthening the tax system.

Such focus will aid in providing an environment that fosters rapid growth in the tradable sector (exports) driving growth in the economy; increases the level and quality of investment leading to a lift in productivity and growth; and increases innovation enabling profitable entities to add higher value.

To this end, Treasury will be concentrating its activities on five key policy areas, providing a range of policy options that the government can consider. It is expected that these policy areas will continue to be a focus for the medium term but emphasis and importance may alter and some new priorities may emerge. The policy areas identified as a focus for the short to medium term are briefly outlined below and discussed in more detail in section 3.

1 Key Policy Area – Efficient and effective use of state spending and assets

Returning to fiscal surplus is crucial to growth, to continuity of vital services and to a stable and sustainable macroeconomic environment. In the short term, improved national savings, and reduced domestic external imbalances (structural deficit) which increases resilience to global economic turbulence are critical. Capital and expenditure management should facilitate resource transfer from the non-tradable to the tradable sector, and a lower exchange rate level, which are foundations of improved export and investment performance as is low and stable inflation at reduced interest rates. Government can better contribute to growth via productive state spending and assets (e.g. infrastructure), a reduction in growth-inhibiting policy and enhanced ability to deliver key outcomes in the face of fiscal pressure.

2 Key Policy Area – Regulatory Reform

Regulation has pervasive effects on firm and individual behaviour, shaping incentives to compete, innovate, invest in new capital, develop skills, and take risks. A high-quality regulatory environment is critical for encouraging competition and permitting resources to move to their most productive use in response to relative price changes. Treasury will support Government to focus improvements on key regulatory impediments.

3 Key Policy Area – Taxation System Reform

Treasury will continue its focus on reviewing the tax system with a view of implementing the next steps in the tax package. This is expected to result in increased investment in productive and entrepreneurial activity. Effective tax reform is an ongoing process. We will continue to work with others to determine how the tax base can be improved, and in particular to assess whether New Zealand's approach to taxing income from capital can be improved to further support the investment required for a change in New Zealand's growth prospects.

4 Key Policy Area – Strengthen human capital and increase labour supply

To address the future demands of a higher skill economy and to mitigate the impact of an aging population, it is important that the average skill levels of the labour supply are lifted and that labour supply is increased. For skills to make the contribution required in the future, a number of difficult policy challenges will have to be resolved. While other agencies have primary accountability in this area, Treasury will work as a Central Agency to support them in their efforts.

5 Key Policy Area – Deepening International Connections

As a small economy, New Zealand needs to be well connected to the rest of the world in order to grow. A lift in the level of connection across trade, people, capital and ideas is necessary in helping overcome our geographical isolation and reducing the costs of distance. Changes here are critical to achieve our aspirations for export performance and innovation. Concentration on this area is currently lower than in other areas because the nature of the policy responses to this issue are defuse and in some cases uncertain.

3. The major pressures facing the Vote(s) over the forecast period. Where possible these should be quantified.

Departmental activities

Treasury is both a policy agency delivering economic, financial and regulatory advice to Ministers, as well as an agency with significant operational roles (Crown financial accounting and reporting, NZ Debt Management Office (DMO), NZ Export Credit Office, and Deposit Guarantees (DGS)). Operational activity accounts for 30 percent of Treasury's total funding for 2010/11 with the remaining 70 percent primarily for policy advice. By 2014/15 the proportion spent on operational activity is forecast to fall to only 10 percent of Treasury's total activities as time limited funding and activities cease.

Treasury baselines will see a reduction of around $15.9 million between 2010/11 and 2014/15, and in the short term a reduction between 2010/11 and 2011/12 of around $12.4 million. The reduction is due to time funded operational activities such as the

Deposit Guarantee Scheme, Wholesale Guarantees schemes and Administration of Guarantees schemes.

The table below shows the cost of core policy making and operational functions across Treasury:

	$ million				
	2010/11	2011/12	2012/13	2013/14	2014/15
Policy Based Activities - Vote Finance	51.376	51.188	51.501	51.501	51.501
Policy Based Activities - Vote SOE's	4.128	2.748	2.782	2.782	2.782
Policy Based Activities - Vote CRI's	1.074	1.074	1.074	1.074	1.074
DMO and Financial Operations	23.198	12.392	9.496	8.536	8.536
Total Output Expenses[1]	**79.776**	**67.402**	**64.853**	**63.893**	**63.893**

Changes[2] between years

	$ million				
	2010/11	2011/12	2012/13	2013/14	2014/15
Policy Based Activities - Vote Finance	N/A	- 0.188	0.313	-	-
Policy Based Activities - Vote SOE's	N/A	- 1.380	0.034	-	-
Policy Based Activities - Vote CRI's	N/A	-	-	-	-
DMO and Financial Operations	N/A	- 10.806	- 2.896	- 0.960	-
Net change	**N/A**	**- 12.374**	**- 2.549**	**- 0.960**	**-**

Beyond the core legislative requirements associated with its “Finance Ministry” role, Ministers in successive governments have purchased a range of first and second opinion advice from the Treasury.

Treasury generally delivers Ministerial priorities and core business within its baselines; although these may require to be supplemented with one-off funding for significant and unusual projects (e.g. large commercial transactions that may arise), or where broader whole of Government initiatives are coordinated from the centre.

Costs for Permanent Legislative Authority (PLA) funded activities (DMO and DGS) are forecast to increase slightly to account for remuneration and inflationary impacts. Treasury will be look to make efficiencies in these areas to absorb these impacts. However increased costs may arise due to increased transaction volumes. **[2]**

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[1] Numbers reflect baselines as at October Baseline Update 2010 and exclude additional funding approved by Cabinet since that date which will be included in the March Baseline Update 2011

[2] Negative numbers represent a reduction in funding

[2]

While Crown funded policy advice and operational (non DMO and DGS) funding is expected to remain relatively constant in real terms over the next 4 years, the impact of future remuneration and inflationary impacts mean that these baselines will be under significant pressure as input cost increases need to be absorbed. The remainder of the Four Year Budget Plan concentrates on non-PLA funded outputs that will face funding pressures.

Current forecasts by the Treasury for the non-PLA funded outputs (i.e.; excluding DGS and most DMO functions), based on the latest assumptions; factoring in efficiency savings, anticipated inflation rates expected remuneration pressures and turnover, would indicate the following funding opportunities and risks when compared against the current baselines referred to above:

By Appropriation type ($000)	2010/11	2011/12	2012/13	2013/14	2014/15
Policy Activities and Operational Non – PLA[3]	2,200	700	(826)	(2,531)	(5,458)

For Treasury to live within its current baselines, it will need to start reducing costs in 2012/13 by approximately $1 million. It will then need a further reduction of $1.5 million in 2013/14 and then an additional $3 million in 2014/15.

We do not envisage there to be a significant shift in resources across the Treasury's output expenses in 2011/12, although some proposed fiscally neutral adjustments may be sought during the year to ensure sufficient resources are redirected to the highest priority areas. This is likely to impact all votes particularly through the 'Efficient and effective use of state spending and assets' policy area.

Treasury has identified costs for development work in 2010/11 and 2011/12 where no dedicated funding has been provided in existing Vote baselines for and they are therefore considered "unfunded". The value of these costs is not included in the financial summary included above.

These are discussed in more detail under Section 3 below, but in summary these are in respect to:

- the management of risk across the Crown's balance sheet. The quantum will be subject to further work over the next 6 – 8 months and will be influenced by the need to significantly change practices in capital and asset management, and in some cases to manage asset disposal (e.g. South Canterbury Finance). A portion of forecasted under spend of $0.3 million will be retained in 2010/11 to be applied to this work;

[3] Negative amount reflects a forecast deficit/shortfall in funding

- any new or extended broad initiatives reviewing expenditure, performance, etc. if these were required to support an even tighter fiscal environment;

- additional work on national infrastructure, particularly with respect to public-private partnership work and a centre of excellence; and

Treasury has a forecasted under spend and uncommitted funding of $2.2 million in 2010/11 and $0.7 million in 2011/12 which could be applied to address the fiscal costs outlined above. However Treasury would not be in a position to absorb more if the cost of these items exceeds $2.9 million. Treasury proposes to retain $0.3 million in 2010/11 and to transfer the $1.9 million from 2010/11 to 2011/12 to assist in addressing this development work.

Non-Departmental activities

In the non-departmental activities, specific fiscal costs expected to materialise in the medium term and will need to be funded from the capital allocation are:

- Subject to accounting treatment advice from Treasury's auditors, the accumulated capital costs, interest and losses/(profits) on properties held under the Protected Land Agreement by Landcorp Farming Limited of approximately $8-10 million.

[2]

In addition, the following fiscal cost pressures are still subject to Ministerial decisions. Decisions made will impact on the necessity for these to be funded out of the capital allocation:

[2]

- The International Monetary Fund is undergoing a set of quota and governance reforms which are likely to impact on New Zealand's financing commitments at the Fund. As a result of the reforms, New Zealand's quota (or shareholding) is likely to double. However this will likely be offset by a corresponding reduction in New Zealand's commitments under the New Arrangements to Borrow.

- New Zealand House capital refurbishment costs of $150 million in the short term with at least one, and possibly two, similar refurbishments likely to be needed before 2048. This cost pressure may be avoidable if alternative accommodation is found.

If future budgets do not have a capital allocation, these cost pressures will need to be funded through reprioritisation across the Crown Balance Sheet.

Whole of Government activities

Cabinet recently agreed [CAB Min (10) 38/4B] to Treasury proceeding with the next phase of the BASS programme. This included undertaking further benchmarking of agencies administrative and support services, development of an indicative business case and developing a proposal for a property centre of excellence. The costs for benchmarking were agreed to be funded from participating agencies with Treasury absorbing the other costs associated with progressing the BASS programme to the point where a detailed business case could be initiated.

At the same time Cabinet invited the Minister of Finance to ECC in February 2011 on outcome of the indicative business case and funding implications for the development of the detailed business case.

[2]

As noted above, Treasury proposes to carry forward the forecast under spend to meet higher priority areas in 2011/12 being crown balance sheet work, state sector reform initiatives or infrastructure priorities. Therefore it is not in a position fund detailed business case. Treasury did consider whether the forecast under spend should be applied to the BASS programme. However as all agencies benefit from such initiatives, we believe funding should either be accessed from the agencies benefiting (i.e. through subscription funding based on property portfolio size or performance or through pulling forward outyear funding from those votes that are most likely to benefit) or additional funding appropriated and funded from the Budget 2010 Between Budget Contingency through the Cross Agency Initiatives Process (CAIP): a process for departments seeking funding for significant cross agency or all-of-government initiatives.

A further fiscal cost has been identified to establish a property management centre of expertise in the Ministry of Social Development (MSD), which arises out of the BASS work programme. This is estimated at $600,000 in 2011/12 and $400,000 in 2012/13. Given fiscal costs faced by Treasury in other development areas, it is not in a position to absorb the establishment costs of this unit. It has been included as budget initiative at this stage but will be subject to further work by the lead agency, Ministry of Social Development (MSD) and the BASS project team in Treasury. The funding proposal for the property management centre is being signalled Treasury's four year budget plan rather than Social Development's only because the current responsibility for the BASS work programme sits with Treasury.

Finally, the international macroeconomic risks are real and ongoing. It is not clear that the global financial crisis and consequential policy responses have resolved, in any sustainable way, the causes of the global financial imbalances that emerged in the 1990s. It is expected that policy may need to respond to large negative shocks from a volatile global economy in what looks like an extended period of heightened uncertainty. An allowance for this type of event has not been factored into Treasury's forecasts.

4. The drivers of costs in the Vote(s) (e.g. inflation/price pressure, demographic changes, one-off pressures).

As a knowledge organisation, personnel will always be a large proportion of the cost of the Treasury. As personnel costs will continue to be a high proportion of Treasury's overall forecast costs, how Treasury manages these cost will need to be a key focus as part of this plan.

The activities that have been introduced into Treasury, like the Deposit Guarantee Scheme, National Infrastructure Unit and NZ Export Credit Office, over the last couple of years have required the recruitment of new specialist skills. Anticipated changes in the practices in capital and asset management are likely to see a continuing need to recruit or buy in unique skills and experience, rather than transfer resources from within Treasury.

Therefore the movements in remuneration and the future shape of the organisation will have a large impact on the overall financial position. There will be increased pressure to adjust ranges and actual salaries to recognise cost of living adjustments in the future, and the new remuneration model has been designed to allow for this to be part of the decision making process.

5. The measures being put in place to manage these pressures within the Vote(s).

As indicated above, the Treasury must manage its out year work programme and resource it in a way that is both efficient and effective, but also ensures that appropriate and defined disengagement strategies are in place for time limited projects, task forces etc, so that when the work ceases so do the related costs.

Treasury will continue to adopt strategies to ensure it can provide efficient and effective services to Ministers within the resources available to it. This will include:

- Continuing to improve the efficiency of its own processes and systems to reduce costs;
- Continuing to invest in people and systems to develop the skills required to deliver more with less;
- Analysing the capability of senior technical resources to deliver more;
- Ensuring efficient decision-making around priority work and the allocation of resources to these, and thus decreasing effort in lower priority areas;
- Providing a more targeted effort in vote analysis work; focussing on sector wide and more substantial in depth reviews rather than providing ongoing constant oversight;
- Carefully managing exiting from activities where time limited funding has previously been allocated; and
- Increasing cross agency collaboration to deliver joined up advice and implementation and seek new ideas from external sources (e.g.: working groups) to supplement Treasury expertise.

Treasury's long-term focus will continue to be on examining ways to meet increasing cost pressures within relatively fixed baselines, while minimising the impact on priorities. The Treasury's business planning processes are intended to support this by:

- encouraging an approach that is driven by the agreed strategic priorities and outcomes;
- continuing to reassess the optimum level of staffing (both value and number) and future recruitment needs based on the anticipated work and funding over the medium term; and
- developing and implementing processes around prioritisation of resources across the Treasury, aligned with its medium term finance strategy.

6. What risks do these pressures create?

As noted elsewhere, the lower level of resourcing may impact on Treasury's ability to deliver to Ministers expectations and impede the contribution of Treasury advice on the key elements to drive economic growth. As Treasury prioritises and focuses its efforts where it may have the most impact, it may diminish our ability, immediately or deeply, to respond to spending or policy proposals from agencies on topics that are not deemed "priority".

Section 3: Proposed Changes for Budget 2011 (Reprioritisation)

Departmental output expenditure

As identified in section 2 above, Treasury baselines will see a reduction of around $15.9 million between 2010/11 and 2014/15, and in the short term a reduction between 2010/11 and 2011/12 of around $12.4 million. The reduction is due to time funded operational activities such as the Deposit Guarantee Scheme, Wholesale Guarantees schemes and Administration of Guarantees schemes.

For Treasury to live within existing baselines, it will need to start reducing costs in 2012/13 by approximately $1 million; with the need for a further reduction of $1.5 million in 2013/14 and a further $3 million in 2014/15.

<u>Strategies to manage funding pressures</u>

The focus over the next 12- 18 months will be for Treasury to gain further clarity on the steps needed to deliver 4% per capita GDP growth. This includes specifying between the impact Treasury can make and the role that other agencies in public sector need to play.

As baselines reduce in the out years, further prioritisation will be required and the Treasury has been working with Ministers to identify priorities for the medium term and indicative sequencing. It is expected that these priorities will continue to be a focus for the medium term but emphasis and importance may alter and some new priorities may emerge.

While Treasury will first try to maintain existing deliverables and close the funding gap through improved efficiency, if it needs to reduce the scope of its operations it will need a robust process for determining which areas are of lower value.

To this end, Treasury have been reviewing their strategic planning process to allow for a better line of sight to their objectives and to support a better allocation process. The practical implication is that Treasury will have to prioritise more dramatically. In order to maintain critical mass on priorities there will be more “non-priority” areas where Treasury will not be able to support Government as fully in its consideration of spending or policy proposals. It will need to focus more on key priorities and less on “across the board” advice.

Treasury will continue to work with Ministers as part of their planning process to prioritise activities across the Votes more systematically. This will require judgement to be applied to identify key priorities, sequencing of activity and work that can be deferred or ceased.

If done successfully this should allow Treasury and Ministers to identify key priorities, make sure that these are resourced well and identify the areas that should be stopped or reduced.

Provided there are no changes to Treasury's activities, the funding challenges are 12-18 months away. There is sufficient time to embed a robust reprioritisation process. Without effective management, there would be a risk of ad hoc reprioritisation decisions and a general running down of the Treasury's capability, leading in turn to Treasury not meeting the ongoing needs of Government and not being effective in its broader leadership role across government.

Personnel related costs

Personnel related costs will continue to be a high proportion of total Treasury's overall forecast input costs. To manage other cost pressures associated with inflation and remuneration increases, the primary lever for the Treasury to manage within baselines over the medium term is through the reduction in staffing resources. The current staffing complement of approximately 390 FTEs is not financially sustainable.

[3]

An important step to allow remuneration pressures to be controlled was taken by the Treasury in 2010/11 through a remuneration review. Removal of a step-based system and implementation of a matrix framework allows for more directive budget control of remuneration pressures. **[3]**

. It may also be possible to look to lower this estimated remuneration cost, but this will be dependent on labour market conditions and the skill mix required to deliver services over the next few years.

Another of the key components of personnel cost is the vacancy rate and lag in hiring for vacant roles. Treasury's history of under spends has in part been caused by underestimating its vacancy rate. A 3.5% turnover/vacancy lag (calculated on total salary costs) of approx. $1.5m has been assumed. Cutting or delaying the hiring of vacancies is the simplest way to reduce the personnel budget and appropriate vacancy management will be an important part of ensuring that Treasury lives within its baselines over the medium term.

As demand grows and the workforce shrinks Treasury is going to need to operate more flexibly. It will need to retain key specialists as 'anchors' of expertise, but for much of the rest of its workforce it will require people with the skills and personal attributes enabling them to span the business more broadly. Treasury has initiated work during 2010/11 to develop an explicit strategy about the skill and experience mix needed and how that mix is best utilised.

In addition, the higher focus to be applied to the priorities outlined above will require re-allocation and rationalisation of staffing. This will be undertaken by:

a) Rationalisation of staff – a number of areas will be investigated:
   i. A reduction in the number of managers resulting in larger teams. This will have subsequent flow on effects on corporate and support size. Risks associated are reduction in quality assurance of policy advice as managers are spread thinner and less efficient operation of administration activity as some tasks may fall back on policy analyst resources.
   ii. A reduction in corporate support staff arising from efficiencies obtained either through integrated state sector services or from process improvements (for example arising from BASS or PIF reviews).
   iii. A reduction in staff currently assigned to policy work that is prioritised lower.
   iv. A reduction in staff allocated to delivery of core work by holding agencies to account for work they should be leading or delivering to a particular quality standard or through efficiencies obtained from process improvements.

b) Clear prioritisation for projects and activities to enable appropriate recruitment and reallocation to obtain required skill mix. (e.g.: Additional policy work on longer term state sector performance and strategy will be resourced by providing a more targeted effort in vote analysis work; focussing on sector wide and more substantial in depth reviews rather than providing ongoing constant oversight. **[3]**

Utilising Financial Management tools to allow flexibility to reprioritise funding

In order for Treasury and the Minister to have greater flexibility to amend priorities in the future, it is proposed that the appropriation structure for Treasury is simplified with application from 2011/12. One of the biggest issues we face to mitigate risk is the number of Ministers required to get approval from to cover off risks in one Vote compared to another. I, as Secretary, do have the ability (via Multi Class Output Appropriations) to transfer funds from one Output Expense to another. That is however limited to the MCOA's and within the same Vote, and the proposal is to review the structure of appropriations to allow for better utilisation of this facility.

In addition, we propose that the structure rationalises from three Votes to only Vote Finance. The recommended changes are to achieve product alignment rather than based on organisational structure while maintaining the separation required for different Ministers.

This proposal still needs to be discussed and agreed with Ministers.

The following table outlines the proposed changes:

Current State	Proposed Change	Proposed State	Portfolio Minister
Vote Finance			
Administration of Crown Borrowing PLA	Remain the same	Administration of Crown Borrowing PLA	Minister of Finance
Administration of Derivative Transactions PLA	Remain the same	Administration of Derivative Transactions PLA	Minister of Finance
Administration of Guarantees and Indemnities given by the Crown PLA	Remain the same	Administration of Guarantees and Indemnities given by the Crown PLA	Minister of Finance
Administration of Investment of Public Money PLA	Remain the same	Administration of Investment of Public Money PLA	Minister of Finance
	New	Administration of Local Government Borrowing (Revenue dependent)	Minister of Finance
Macro Economic Policy Advice & Management MCOA - Management of Crown Lending and Crown Bank Accounts	Move from Macro Economic Policy Advice & Management MCOA to Financial Operations output class	Financial Operations	Minister of Finance
Crown Guarantee Schemes	Merge into a Financial Operations output class		
Management of Liabilities, Claims Against the Crown and Crown Properties (part of) [*State Sector and Economic Performance Policy Advice and Management MCOA*]	Move from State Sector and Economic Performance Policy Advice and Management MCOA to Financial Operations output class the costs associated with managing debt		
New Zealand Export Credit Office [*State Sector and Economic Performance Policy Advice and Management MCOA*]	Merge into a Financial Operations output class		
Policy Advice: Economic Performance [*State Sector and Economic Performance Policy Advice and Management MCOA*]	Move from State Sector and Economic Performance Policy Advice and Management MCOA to Policy Advice output class	Policy Advice (MCOA only if Policy Expenditure Review recommendations indicate following split would be appropriate) • Treasury led policy advice • Second opinion advice • Public Finance Act directed activity (i.e. Fiscal Reporting)	Minister of Finance
Policy Advice: State Sector Performance [*State Sector and Economic Performance Policy Advice and Management MCOA*]	Move from State Sector and Economic Performance Policy Advice and Management MCOA to Policy Advice output class		
Management of Liabilities, Claims Against the Crown and Crown Properties (part of) [*State Sector and Economic Performance Policy Advice and Management MCOA*]	Move from State Sector and Economic Performance Policy Advice and Management MCOA to Financial Operations output class all costs but excluding those associated with managing debt		
Economic and Tax Forecasting [*Macro Economic Policy Advice & Management MCOA*]	Move from Macro Economic Policy Advice & Management		

	MCOA to Policy Advice output class		
Fiscal Management [*Macro Economic Policy Advice & Management MCOA*]	Move from Macro Economic Policy Advice & Management MCOA to Policy Advice output class		
Fiscal Reporting [*Macro Economic Policy Advice & Management MCOA*]	Move from Macro Economic Policy Advice & Management MCOA to Policy Advice output class		
Policy Advice: Fiscal and Macroeconomic [*Macro Economic Policy Advice & Management MCOA*]	Move from Macro Economic Policy Advice & Management MCOA to Policy Advice output class		
Crown Company Monitoring Advice to the Minister for State-Owned Enterprises and Other Responsible Ministers	Move from Vote SOEs but retain separate output class as separate Minister	Crown Company Monitoring Advice to the Minister for State-Owned Enterprises and Other Responsible Ministers	Minister of State Owned Enterprises
Crown Company Monitoring Advice to the Minister of Research, Science and Technology and the Minister for Economic Development	Move from Vote CRI but retain separate output class as separate Minister	Crown Company Monitoring Advice to the Minister of Research, Science and Technology and the Minister for Economic Development	Minister of Research, Science and Technology
Establishment of the New Zealand Productivity Commission	Remain the same	Establishment of the New Zealand Productivity Commission (expires in 2010/11)	Minister for Regulatory Reform
Infrastructure Advice and Co-ordination	Remain the same	Infrastructure Advice and Co-ordination	Minister for Regulatory Reform
Vote State Owned Enterprises			
Crown Company Monitoring Advice to the Minister for State-Owned Enterprises and Other Responsible Ministers	Move to Vote Finance but retain separate output class as separate Minister	Refer above	Refer above
Vote Crown Research Institutes			
Crown Company Monitoring Advice to the Minister of Research, Science and Technology and the Minister for Economic Development	Move to Vote Finance but retain separate output class as separate Minister	Refer above	Refer above

This change will allow the Treasury to increase its flexibility in responding to changing priorities. It will assist in ensuring resources are applied to highest priority areas and will also allow a reduction in compliance costs of funding changes. Accountability will be maintained through the effective use of output plan documentation.

What will be new or increased?

[2]

[2]

As noted in Section 2 above, Treasury will be concentrating its activities in five key policy areas. The impact of this work was described above in section two. It is expected that the focus on these policy areas will be enduring for the medium term but emphasis and importance may alter and some new priorities may emerge. Provided below is more detail on the types of work programmes that will be undertaken in short to medium term. The key activities listed will be the focus in 2011/12. Looking out over four years, it is this level of detail which will be amended each year as Ministers review progress and adjust the levers or options in order to achieve the desired step up change in economic growth.

1 Key Policy Area – Efficient and effective use of state spending and assets

Treasury will be taking a leadership role in advising on ambitious deficit and debt targets and providing a roadmap to achieve:

i. A Return to fiscal surplus

ii. A public sector that delivers better advice and services with less resource (working with Central Agencies), and

iii. A well-managed balance sheet with an asset composition that supports social and economic outcomes.

2 Key Policy Area – Regulatory Reform

Treasury's focus will be to support Government and to work with other lead agencies for effective review of key pieces of regulation that impact the broad economy. We will also support Government to increase understanding of the impact of regulation on the economy. [2]

3 Key Policy Area – Taxation System Reform

Treasury will continue its focus on reviewing the tax system with a view of implementing the next steps in the tax package. A particular focus will be on the possibility of broad reform of capital income taxes. [2]

[2]

4 Key Policy Area – Strengthen human capital and increase labour supply

Treasury's policy work will be concentrated to:

i. Ascertain the future direction of early childhood education support and quality

ii. Lift teaching quality

iii. Shift 15-19 year old engagement in education teaching

iv. Get more young people participating and achieving higher qualifications in a responsive tertiary system

[2]

5 Key Policy Area – Deepening International Connections

[2]

Additional fiscal cost pressures and strategies to address these

As noted in section 2 above, Treasury has identified costs in 2010/11 and 2011/12 where no dedicated funding has been provided for and they are therefore "unfunded". These are:

- the management of risk across the Crown's balance sheet.
- additional work on national infrastructure;
- any new or extended broad initiatives reviewing expenditure, performance, etc. if these were required to support an even tighter fiscal environment; and

Treasury proposes to retain $0.3 million in 2010/11 and to transfer the $1.9 million from 2010/11 to 2011/12 to assist in addressing this development work.

Management of risk across the Crown's balance sheet

A significant focus on the management of the Crown balance sheet portfolio will see demands on current resourcing to progress this. Additional investment in this area is intended to improve the management of risk across the Crown's balance sheet to support achieving strong financial performance and effective risk management, through improved direct and indirect governance and monitoring. The extent to which additional funding will be required and the quantum will be subject to further work over the next 6 – 8 months and will be influenced by the size and business readiness for any large commercial transactions. The portion of forecasted under spend of $0.3 million retained in 2010/11 will be applied to this work.

In 2011/12 Treasury has uncommitted funding (of around $0.7 million) which we propose reprioritising to direct towards funding future Crown Balance Sheet work. However it is expected that this will not be sufficient to fund the required level of activity and funding options will be explored. It is proposed that any further changes and funding shifts will be included either in the upcoming MBU 2011 process or in OBU 2011 as technical adjustments.

National Infrastructure Unit

The National Infrastructure Unit, established during 2009, ensures the Government's infrastructure programme is strategically sound and helps build a more competitive and productive economy. A key focus during 2010 has been on building on the first version of the National Infrastructure Plan and ensuring that opportunities for greater private sector involvement in infrastructure development are implemented. Treasury has already reprioritised $0.3 million internally to fund this. The work by the Infrastructure Unit links closely with wider efforts to improve the management and performance of the Crown's balance sheet being undertaken by the new Crown Ownership Monitoring Unit (COMU). **[2]**

Initiatives reviewing expenditure, performance

Treasury have identified as a high priority the efficient and effective use of state spending and assets, including achieving a public sector that delivers better advice and services with less resource. Although Treasury will absorb the costs associated with policy advice on structural reform and legislative change, the implementation of any structural reform will have cost pressures that have not been included in forecasts.

In addition, if the current performance improvement programme is extended then Treasury may face fiscal pressures which are currently unfunded. Treasury contributed $1 million over 2009/10 and 2010/11, expected to fund the agreed work programme until December 2011.

Non-Departmental Expenditure

The Vote Finance Non Departmental appropriations consist of a number of significant unrelated items.

The Treasury has no influence over many of the non-departmental appropriations it administers as they are governed by legislation or relate to binding agreements and contracts between the Crown and a Third Party, membership obligations or borrowing costs.

These include Government Superannuation Fund, National Provident Fund, Taitokerau Forests Limited, Deposit Guarantee Scheme, International Financial Institutions, Borrowing Costs (which continue to increase as the Crown takes on more debt), Management of Contingent Liabilities arising from Crown Balance Sheet asset sales, Unclaimed Monies, NZ Productivity Commission and Sundry items for protected land, 2025 Taskforce and Management of New Zealand Superannuation Fund. Current forecasts reflect the latest information that Treasury have received regarding these appropriations.

In the non-departmental activities, specific fiscal costs expected to materialise in the medium term and will need to be funded from the capital allocation are:

- Subject to accounting treatment advice from Treasury's auditors, the accumulated capital costs, interest and losses/(profits) on properties held under the Protected Land Agreement by Landcorp Farming Limited of approximately $8-10 million may need to be recognised. In 2009/10, Vote Finance incurred unappropriated expenditure of $6.056 million. [6]

  Treasury are currently in discussion with their auditors as to whether the estimated current value of the accumulated capital costs and accumulated losses/(profits) on other properties held under the Protected Land Agreement by Landcorp Farming Limited should be appropriated. The value at 30 June 2010 was $8 million.

- [2]

In addition, the following fiscal cost pressures are still subject to Ministerial decisions. Decisions made will impact on the necessity for these to be funded out of the capital allocation:

- [2]

- The International Monetary Fund is undergoing a set of quota and governance reforms which are likely to impact on New Zealand's financing commitments at the Fund. As a result of the reforms, New Zealand's quota (or shareholding) is likely to double. However this will likely be offset by a corresponding reduction in New Zealand's commitments under the New Arrangements to Borrow. The main impact is anticipated to be an increase in the size of the contingent liability currently included in the Statement of Contingent Liabilities and Contingent Assets but until the reforms are finalised this will not be certain. Votes are yet to be taken on the reforms but it is likely that the changes will be implemented in 2012.

- Treasury administers the property management services and the operational costs associated with New Zealand House, London, via a contract with a facilities management company. NZ House provides office accommodation in London for the High Commission and other government agencies which together occupy 25% of the floor space with the other 75% let by the New Zealand Government to commercial entities. The property is held on a "peppercorn lease" from the Crown Estate (UK). This lease gives the New Zealand Government the beneficial rights to the property until the lease terminates in 2048. NZ House is overdue for a major refurbishment at a likely cost in the order of $150 million. At least one, and possibly two, similar refurbishments are likely to be needed before 2048. Because of this, the future of New Zealand House in London is currently being reviewed. The upgrade of NZ House is currently included in the Crown accounts as a fiscal risk. A decision to remain in NZ House will require the crystallisation of this risk and hence a call on new capital funding. Current appropriations in the October Baseline Update 2010 allow for the ongoing operational costs of the status quo position only.

Non-Departmental Revenue

Vote Finance collects revenue from a number of sources, over which Treasury has no direct influence over. Current forecasts are consistent with known Treasury information. Revenue can be categorised as follows:

- The Treasury (NZDMO) invests public monies as and when required to fund government operations, provide short term liquidity if required and help repay maturities in the longer term. Interest is received from these investments.
- The Treasury provides ownership, performance monitoring and governance advice to Ministers in relation to SOE's, CE's, CRI's and other Crown companies, as part of their core business. This advice may have influence over the amount of dividend which is paid by the entity.
- Treasury also provides advice on the recovery of funds in relation to the entities that have failed under the Government Guarantee Schemes and therefore will have limited influence.
- The Treasury collects the fees in relation to the Government Guarantee Schemes, EQC and Export Credit Office. Deposit Guarantee Fees are set in the Deeds of Guarantee. Export Credit fees are guided by some international guidelines on

minimum fees; being OECD Arrangement on Export Credits and The World Trade Organisations agreement on subsidies

- Capital charge charged to Departments and Crown Entities is received by the Treasury. The Treasury provides advice on the Capital charge policy and the rates therefore indirectly influencing the income. Current forecasts are based on the existing policy and rates.
- Interest earned on unclaimed monies.

Whole of Government activities

Better Administrative and Support Services (BASS) Programme

Cabinet recently agreed [CAB Min (10) 38/4B] to Treasury proceeding with the next phase of the BASS programme. This included undertaking further benchmarking of agencies administrative and support services, development of an indicative business case and developing a proposal for a property centre of excellence. The costs for benchmarking were agreed to be funded from participating agencies with Treasury absorbing the other costs associated with progressing the BASS programme to the point where a detailed business case could be initiated.

At the same time Cabinet invited the Minister of Finance to ECC in February 2011 on outcome of the indicative business case and funding implications for the development of the detailed business case.

[2]

As noted in section 2, Treasury proposes to carry forward the forecast under spend to meet higher priority areas in 2011/12 being crown balance sheet work, state sector reform initiatives or infrastructure priorities. Therefore it is not in a position fund the detailed business case.

Treasury did consider whether the forecast under spend should be applied to the BASS programme. However as all agencies benefit from such initiatives, we believe funding should either be accessed from the agencies benefiting (ie through subscription funding based on property portfolio size or performance or through pulling forward outyear funding from those votes that are most likely to benefit) or additional funding appropriated and funded from the Budget 2010 Between Budget Contingency through the Cross Agency Initiatives Process (CAIP): a process for departments seeking funding for significant cross agency or all-of-government initiatives.

A further fiscal cost has been identified to establish a property management centre of expertise in the Ministry of Social Development (MSD), which arises out of the BASS work programme. This is estimated at $600,000 in 2011/12 and $400,000 in 2012/13. Given fiscal costs faced by Treasury in other development areas, it is not in a position to absorb the establishment costs of this unit. It has been included as a budget initiative at this stage but will be subject to further work by the lead agency, Ministry of Social Development (MSD) and the BASS project team in Treasury. The funding proposal for the property management centre is being signalled in Treasury's four year budget plan rather than Social Developments only because the current responsibility for the BASS work programme sits with Treasury.

Furthermore, the outyear implications of any initiatives arising from the detailed business case stage have not yet been quantified. It is difficult to quantify these until the business case has been completed. It can be assumed that if work carries on from the business case then there is likely to be anticipated savings which should cover any initiative costs. However, there may be some front loading of the costs with savings arising in outyears.

Longer term, there is a question of what should be encompassed in the BASS work programme and where responsibility for that should sit. While it is agreed that the Treasury should manage and design the ongoing data collection process to minimise compliance costs and build on existing data collection processes, Treasury is not considered the most appropriate agency to continue the next phase of this programme.

[2]

While Treasury see longer term benefits in progressing the BASS work programme, there needs to be consideration as to who should have ongoing responsibility for the next phase of BASS initiatives.

There are a number of cross agency initiatives under development or likely to come forward in the next few years. It will be important to ensure that any funding decision is in line with how government envisages such initiatives being funded in the longer term, without creating disincentives for agencies to volunteer taking on cross agency leadership roles.

It is proposed that all agencies benefiting from such initiatives could bear the costs, given that future benefits will accrue to all agencies. This could be via subscription funding based on property portfolio size or performance or through pulling forward outyear funding from those votes that are most likely to benefit.

A further funding option would be additional funding appropriated and funded from the Between Budget Contingency through the Cross Agency Initiatives Process (CAIP): a process for departments seeking funding for significant cross agency or all-of-government initiatives.

Section 4: Summary of Financial Movements

This section details the changes to appropriations (including new appropriations) which are required to implement all of the proposed changes in section 3.

Departments should generate this report from CFISnet.