The Treasury

Budget 2011 Information Release

Release Document

June 2011

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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.

Date: 18 March 2011 BM-2-4-2011-1

THE TREASURY
Kaitohutohu Kaupapa Rawa

To: Minister of Finance

AIDE MEMOIRE: SETTING THE ACC NON-EARNERS' ACCOUNT APPROPRIATIONS FOR BUDGET 2011

This aide memoire provides you with Treasury's recommendation for the ACC Non-Earners' Account Appropriations for Budget 2011 to accompany the recommendations provided by ACC and the Department of Labour (DoL) contained in the papers they provided to the Minister for ACC and forwarded to your office.

DoL supports ACC's proposed appropriation level. The Budget Ministers' paper for Tuesday's meeting includes ACC's proposed appropriation figures, and not Treasury's recommended levels, which are lower.

ACC's proposed appropriation for 2011 reflects continued improvement in performance

ACC performance is tracking significantly ahead of what it was projecting at the start of the year when they forecast a surplus of $54m. Based on experience to 31 December 2010, they are now projecting a surplus in the Non Earners' Account of over $330m Overall, the Corporation is projecting a $3.6 billion surplus for the Scheme at the 30 June, which will reduce its net liabilities from -$10.25 billion at 30 June 2010 to -$6.62 billion.

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ACC attributes around two-thirds of the improvement to improved claims experience and subsequent change in valuation, with the remainder better than expected investment returns, offset by a change in discount rate, and the as yet unknown impact of the Christchurch earthquake.

As a result of its valuation, ACC is recommending a reduction of $428m across the forecast period, as shown below. ACC's funding policy means that savings are spread across three years, rather than being returned to the Crown.

	2010/11	2011/12	2012/13	2013/14	2014/15	Total
BEFU 2010 (excl DoE)	1,246,821	1,265,907	1,313,798	1,344,202	1,344,202	
ACC valuation (excl DoE)		1,088,386	1,180,559	1,259,985	1,310,933	
Reduction from BEFU 2010		**177,522**	**133,239**	**84,217**	**33,269**	**428,247**

ACC took a prudent approach to its valuation. It has incorporated favourable experience that it considered sustainable, but has only partially taken into account other favourable experience when it is less certain that it is sustainable. The valuation has allowed for superimposed inflation for home and community support services to respond to pressure on the price and hours in the sector. ACC's valuation was independently reviewed by the DoL's actuaries who considered it reasonable.

While ACC's prudent approach to setting its baseline is appropriate when considered over the medium term, we consider that there is scope for further reductions in the out-year appropriations

Our view is that ACC's approach is appropriate when viewed over the medium term. However, we think it is likely that ACC will continue to make gains and have consequently recognised more of the recent improvements than they have, as well as other initiatives that they are developing. We have also looked at the NEA appropriation level in light of both ACC's improved performance and the significant growth that occurred between 2004/05 and 2009/10, and as a result consider that there is scope for reductions in the out year appropriations.

Options for reducing the out-year appropriation

We have identified two options for a reduced appropriation in the out-years. We have discussed these options with DoL and ACC. The two options, which are consistent with the requirement for ACC to be fully funded, are shown below:

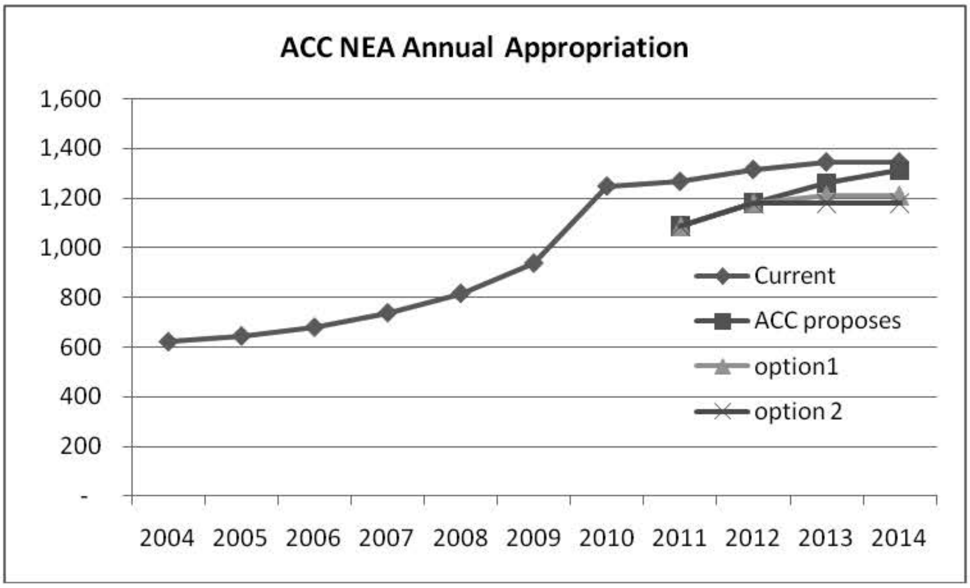
- Option 1 – reducing the level of the appropriation in 2013/14 and 2014/15 by the level of savings projected in 2012/13, as shown in the table below.

Option 1	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**Total**
Revised baseline		1,088,386	1,180,559	1,210,963	1,210,963	
Reduction from BEFU 2010		177,521	133,239	133,239	133,239	**577,238**

- Option 2 – rolling forward 2012/13 baseline (this was the approach we took last year), as shown in the table below

Option 2	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**Total**
flat baseline from 12/13 year		1,088,386	1,180,559	1,180,559	1,180,559	
Reduction from BEFU 2010		177,521	133,239	163,643	163,643	**638,046**

The graph below shows ACC's proposed baseline, and the two options outlined above. Note that the level of the NEA roughly doubled between 2004/05 and 2009/10, although the projected performance to 30 June 2011 will have reduced this significantly, to around 60%.



Option 2 is our preferred option. While we recongise that there is a risk that ACC will seek funding in future years for a level closer to the appropriation they projected, this is a risk that exists already. ACC bases its funding requirement on its valuation, and not prior year forecasts. Therefore ACC will seek additional funding if its valuation finds that this is required, regardless of whether this is more or less than what was projected in the previous year. And by supporting ACC's proposed funding level for 2011/12, we are not undermining the full funding policy.

Furthermore, we would expect, based on recent performance, that ACC is likely to make a surplus in 2011/12 and 2012/13, which would offset the proposed reducutions in the two following years, consistent with the three year funding policy.

Finally, Cabinet does not treat the NEA appropriation as a forecast item and therefore has choices in how it sets the level. This is the same approach it has when setting levies in the levied accounts. Its decisions have signalling effects. Reducing the appropriation level in the out years can be seen as both a signal of the Government's ongoing expectation of fiscal prudence, as well as a vote of confidence that ACC will continue to make the performance gains it has achieved in recent years.

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