The Treasury

Budget 2014 Information Release

Release Document

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[13] Not in scope

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Briefing for 2014 Budget Bilateral with Minister Parata on 18 February

Date:	14 February, 2014	**Report No:**	T2014/187
		File Number:	DH-4-1-1-2014

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note** the contents of this report	Before meeting with Minister Parata on 18 February

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[3]				✓
Grace Campbell-Macdonald	Manager, Education and Skills	04 917 6958 (wk)	[3]	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Enclosure: No

Treasury Report: Briefing for 2014 Budget Bilateral with Minister Parata on 18 February

Executive Summary

There is a total of [7] of new spending sought over four years for Vote Education in Budget 2014, including 'Investing in Educational Success'. This vastly exceeds the indicative allocation for Vote Education and the remaining unfunded gap is significant at $309.8 million over four years.

Forecast changes from OBU 2013 and MBU 2014 should be the first call on any available funding. These total $404.3 million across the four-year forecast period and $136.9 million in 2017/18 and outyears, driven primarily by increases in ECE volumes. There are a number of other initiatives that Treasury considers to also be high priorities for funding, which total $169.7 million across the four-year forecast period and $45.7 million in 2017/18 and outyears.

Treasury recommends pursing two options in combination to manage this fiscal pressure. The first is to direct the Ministry to withdraw discretionary and lower value initiatives and find further savings within the Vote, more aggressively reprioritising from current low-value spend. The second is to use upcoming decision-making forums like Social Sector Ministers' meetings to test the relative priorities of initiatives both within Vote Education and across Votes.

Recommended Action

We recommend that you:

a **note** that there is a total of [7] of new spending over four years currently sought in Vote Education

b **note** that after taking indicative allocations into account, there remains $309.8 million unfunded over four years, and a particular issue in 2017/18 and outyears.

c **note** that OBU 2013 and MBU 2014 changes make up a considerable proportion of the funding sought in Vote Education

d **invite** the Minister of Education to scale back her current set of initiatives and identify further reprioritisation options

e **consider** using upcoming Ministerial meetings to reprioritise from the wider Budget 2014 allocation towards Vote Education

f **discuss** with the Minister of Education the value of undertaking policy work to reduce the risk that forecast changes pose to the Vote in future Budgets

Grace Campbell-Macdonald
Manager Education and Skills

Hon Bill English
Minister of Finance

Treasury Report: Briefing for 2014 Budget Bilateral with Minister Parata on 18 February

Purpose of Report

1. This report provides you with information on the state of the Vote Education package for Budget 2014 (B14) ahead of your meeting with the Minister of Education on 18 February. It summarises the current initiatives submitted by the Ministry of Education, including the implications of the October Baseline Update (OBU) and March Baseline Update (MBU) forecast changes on the allocation. It also outlines the Treasury's provisional assessment of these initiatives and options for achieving a balanced package.

Current State of Vote Education Budget Package

There is a total of [7] of new spending sought over four years in Budget 2014....

2. A revised Four-Year Plan (4YP) for Vote Education was submitted to you on 30 January 2014, which incorporated the 'Investing in Educational Success' package of initiatives that had previously been withheld. The total cost of initiatives included in the 4YP was [7] across the four-year forecast period, and [7] 2017/18 and outyears.

3. Subsequently the Ministry has completed its forecast changes to be included in its MBU. The total cost of these forecast changes is $221.6 million across the four-year forecast period, and $71.3 million in 2017/18 and outyears.

4. The following table summarises the total funding sought in Vote Education at this point in time.

	13/14	14/15	15/16	16/17	17/18	Four Year Total
Investing in success	0	5.5	74.6	124.3	154.8	359.2
OBU 13 forecasts	10.5	38.1	37.4	31	65.6	182.6
MBU 14 forecasts	16.1	27.2	45.6	61.5	71.3	221.7
Everything else	[7]					
Total funding sought	[7]					

....and this vastly exceeds the indicative allocation for Vote Education....

5. The indicative Budget allocation for Vote Education can be thought of as comprising two components.

6. The first component is the funding for the Investing in Educational Success package of initiatives, which Cabinet agreed to establish a contingency for as part of the Budget 2014 process (CAB Min (14) 1/14 refers). The total cost of this contingency will be

$359.2 million across the four-year forecast period, and $154.8 million in 2017/18 and outyears. These amounts have been announced publically by the Prime Minister and are referenced in the parameters for the Sector Working Group.

7. The second component is the indicative allocation signalled by Ministers to cover the remainder of the initiatives seeking funding through Budget 2014. This is currently assumed to be $450.0 million across the four-year forecast period, and $112.5 million in 2017/18 and outyears.

8. The savings initiatives currently proposed by the Ministry total [7] across the four-year forecast period and [7] in 2017/18 and outyears.

....and the remaining unfunded gap is significant.

9. While there are some savings are on the table, the remaining unfunded gap remains sizeable. The following table summarises the remaining unfunded gap in the current Vote Education package for B14:

	13/14	14/15	15/16	16/17	17/18	Four Year Total
Total funding sought	[7]					
Allocation for Investing in Success	0	5.5	74.6	124.3	154.8	359.2
Allocation for Other Initiatives and to meet forecast changes	0	112.5	112.5	112.5	112.5	450
Savings and Reprioritisation	[7]					
Remaining Unfunded Gap in Vote Education	[7]					**309.8**

10. The capital expenditure sought in B14 totals $150.0 million over the four-year forecast period. This is subject to the School Property Programme Business Case which will be considered by Cabinet in coming weeks.

First Calls on Available Funding

11. The Treasury has based its prioritisation of initiatives on only the second component of the indicative allocation, taking the funding set aside for the 'Investing in Educational Success' initiative as a given. This section outlines the initiatives that we believe should be the first calls on any available funding for Vote Education.

Forecast Changes

12. Past practice within Vote Education has been to charge the OBU and MBU forecast changes within the financial year towards the following Budget. Under the current approach, the total fiscal impact of the OBU 2013 and MBU 2014 forecast changes on B14 is:

    a. $404.3 million across the four-year forecast period

    b. $136.9 million in 2017/18 and outyears

13. This means that currently the forecast changes take up approximately 89% of the indicative allocation over the four-year forecast period, and they exceed the indicative allocation for 2017/18 and outyears by $24.4 million.

14. These changes are comprised of four elements where expenditure is based on a forecasting model that projects the volume of service demand based on inputs that are outside of the Ministry's control:

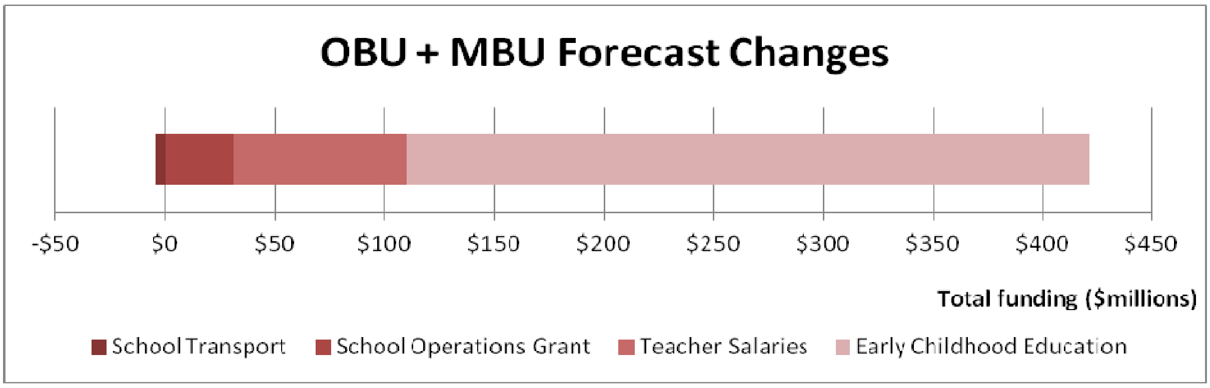
   a. <u>School Transport:</u> Changes to projected school transport demand are based on an adjustment built into school transport contracts to compensate operators and schools for fluctuations in fuel prices, wage increases, changes in Road User Charges and other operating costs.

   b. <u>School Operations Grant:</u> Changes to projected operating grants are based on National School Roll Projections, which are heavily influenced by net migration data from Stats NZ. They are also influenced by school closures and mergers, and a range of other minor reconciliations.

   c. <u>Teacher Salaries:</u> Changes to projected teacher salaries are based on forecast full-time teacher equivalents, which are influenced by school roll projections. They are also based on an assessment of the level of movement between steps on salary scales, and ACC rates and superannuation subsidies.

   d. <u>Early Childhood Education:</u> Changes to projected ECE subsidies are based on volume growth, which is influenced by the labour market and economic outlook, the impact of mergers and new services, participation initiatives relating to the 98% BPS target, and net migration levels.

15. The following graph shows the distribution of the total fiscal impact of the OBU and MBU changes across the four categories above. It shows that ECE forecast changes make up nearly 75% of the total:



16. We note that a portion of the total cost of the OBU 2013 forecast changes aren't charged against B14. This is because the ECE Participation Contingency set up at Budget 13 has already been drawn down to fund $65.1 million of the ECE forecast changes. This offsets the impact on this Budget, and is excluded in the analysis above.

17. This contingency was set up in anticipation of increased demand in ECE volumes that were expected as a result of progress towards the BPS 98% Target. The changes in OBU 2013 and MBU 2014 indicate that the mid-point estimates of the Ministry's forecast models are for significant growth in the ECE volumes, which corresponds with the Government's BPS policy target.

Other High Priority Initiatives

18. In addition to the forecast changes, there are a number of initiatives that Treasury considers to be high priorities for funding in B14. This is because these initiatives either:
    a. Fund expenditure that is non-discretionary

    b. Fund expenditure that is directly linked with Government priorities

    c. Fund expenditure for which we believe there is good evidence of effectiveness

19. Together, these initiatives cost $169.7 million across the four-year forecast period and $45.7 million in 2017/18 and outyears, as shown in the following table:

Initiative	2017/18 and Outyear Cost	Four-Year Total Cost
GCERP: Property Components	$3.9 million	$16.9 million
Increased Insurance Premiums	$8.5 million	$34.0 million
Hobsonville Public Private Partnership	$7.2 million	$29.8 million
[7]		
Expansion of Reading Together Project	$0.7 million	$2.4 million
Leaky Buildings Rectification	$0.0 million	$10.4 million
Partnership Schools Further Funding	[7]	
School Property Expansion	$16.0 million	$35.0 million
TOTALS:	[7]	

High-Cost Initiatives with Options for Scaling

20. There are two other high-cost initiatives, which we do not support given that we don't have good evidence of the link between increased marginal expenditure and effectiveness. However, if Ministers choose to fund these initiatives we recommend that they be scaled back from the current levels of funding sought.

21. The following table summarises these initiatives and how we consider they can be scaled:

Initiative	2017/18 and Outyear Cost	Four-Year Total Cost	Assessment and Scaling Options
Cost Adjustment to Operations Grants for Schools	$25.0 million	$86.5 million	- This funding is intended to help schools meet increase operating costs linked to inflationary pressure. - However, we consider these increases discretionary, and have no evidence about the extent to which costs to schools are rising. - This initiative is currently costed on the basis of a 2% universal increase in the ops grant. Scaling to 1.5% would save $20.8 million over four years.
ECE Cost Adjustments	$12.9 million	$51.7 million	- This funding is intended to reduce the cost of ECE to parents but we have no evidence that increases in the last few Budgets have worked

			to reduce prices. - This initiative is currently costed on the basis of a 2% increase in the non-salary subsidy component and $10.1 million into equity subsides. - We would recommend scaling back the percentage increase in the general subsidy rate as far as possible, and tilting any remaining increase in funding towards the equity fund.
TOTALS:	$37.9 million	$137.2 million	

Options to Manage Fiscal Pressures in Vote Education

22. The cost pressures in Vote Education currently considerably exceed the funding available. Treasury recommends pursing two options to manage this fiscal pressure. There is a third option which is possible that we do not recommend.

Option 1: Saving and Scaling

23. The first recommended option should be to direct the Ministry to find savings within the Vote, and more aggressively reprioritise from current low-value spend. [7] The magnitude of funding sought for Vote Education necessitates consideration of savings options that may be challenging to implement. The Minister of Education should be encouraged to put all such options on the table.

24. While this is a worthwhile endeavour, our assessment is that the quantum of savings likely to be generated will not be of a sufficient order of magnitude to close the current funding gap.

25. Savings significant enough to generate the level of funding required to close this gap are likely to require significant policy changes, which would be difficult to make in time for Budget 2014.

26. We recommend that the Ministry be directed to advance work on options to manage the cost pressures arising from demand-driven expenditure within Vote Education. The Treasury's view is that this work is necessary to manage the fiscal risk that forecast changes pose to future Budgets.

27. In addition to savings, the Ministry should be directed to scale back a number of high cost initiatives that are discretionary (including ops grant and ECE adjustments), and defer smaller initiatives that are discretionary and where, in the Treasury's view, there is limited evidence of effectiveness.

Option 2: Reprioritise within the Wider Budget 2014 Allowance

28. The second option is to use upcoming decision-making forums like Social Sector Ministers' meetings to test the relative priorities of initiatives both within Vote Education and across other Votes. Treasury's initial rankings of the initiatives would be a useful starting point for this exercise, and this advice will be provided ahead of these multilateral meetings.

29. Ministers could consider the extent to which they want to reallocate money from the wider Budget allowance towards Vote Education. As set out in this report, the Treasury's view is that a number of the Budget 2014 proposals for Vote Education are non-discretionary cost pressures linked to the Government's priorities.

30. In order to fund the forecast changes and high-priority initiatives set out in paragraph 19 (at the level sought by the Minister of Education), Vote Education would require [7]

31. Adding the funding sought for operations grant and ECE cost adjustments would require an additional $137.2 million across the four-year forecast period and $37.9 million in 2017/18 and outyears.

Option 3: [7]

[7]

[11]