The Treasury

Budget 2018 Information Release

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[40]	not in scope	
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THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Initial advice on potential reprioritisation options

Date:	12 December 2017	**Report No:**	T2017/2646
		File Number:	BM-2-1-2018

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Note** the contents of this report.	For discussion at Budget Matters (20 December 2017).
Associate Minister of Finance (Hon Dr David Clark)	**Note** the contents of this report and **indicate** whether you want to discuss with officials ahead of Budget Matters (20 December 2017).	For discussion at Budget Matters (20 December 2017).

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
William Busfield	Analyst	[39]	[23]	✓
John Marney	Team Leader, Budget & Financial Design	[39]	[23]	

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

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Treasury Report: Initial advice on potential reprioritisation options

Executive Summary

Once the Government's existing spending commitments are met, there is limited room for additional spending within the current fiscal strategy. Consequently, the Minister of Finance has written to portfolio Ministers asking them to review current spending and identify reprioritisation options by 26 January 2018.

In the meantime, the Treasury has undertaken an internal exercise to identify potential savings and areas of focus. In line with previous Treasury advice [TR2017/2576], this has envisaged a two phase process for reprioritisation: phase 1 for short-term savings (mainly through Budget 2018), and phase 2 for reviewing core policy settings driving systemic costs, with a view to rebalancing government spending over the medium term (Budgets 2019 and 2020).

We have identified potential phase 1 reprioritisation options worth up to [37] over the forecast period. In practice, some of these savings will be easier to realise than others, and some would require particularly challenging trade-offs. We have therefore grouped these savings into three loose "risk" categories. There are potential savings of about [37] over the forecast period in the low-risk category; [37] in the moderate-risk category, and [37] in the high-risk category.

For phase 2 we have focused on identifying potential opportunities in key sectors. In practice, we think the focus should initially be on a subset of these.

The Treasury has not consulted with agencies on this content. We will provide further advice once analysis of cost pressure budget bids received on 8 December 2017 is complete and Ministerial reprioritisation responses are received by 26 January 2018. We will liaise with your office about the practicalities of managing this process.

Recommended Action

We recommend that you:

a **note** that the Treasury has undertaken an internal exercise to identify possible reprioritisation options for Budget 2018 and over the medium-term.

b **note** that cost pressure budget bids were received on 8 December 2017 and that we will have a better view of sectoral and systemic cost pressures once analysis of these bids is complete.

c **note** that we will provide you with further advice about reprioritisation once responses from portfolio Ministers have been received (due by 26 January 2018).

d **indicate** whether you want to discuss the contents of this report prior to Budget Matters (20 December 2017).

Yes/no.

John Marney
Team Leader, Budget & Financial Design

Hon Dr David Clark
Associate Minister of Finance

Treasury Report: Initial advice on potential reprioritisation options

Purpose of Report

1. This report responds to your request for a summary of initial Treasury advice on possible sources of baseline reprioritisation. It is just for your information at this stage. We have not consulted with agencies on the content.

2. We will provide firmer advice about reprioritisation options once cost pressure information has been analysed and agencies have provided their own baseline spending analysis.

Context

3. The Budget 2018 and Fiscal Strategy Cabinet paper stated:

   > *Once the Government's spending commitments* [through Budget 2018] *are accommodated, there is very little room for any additional spending in order for us to meet the Government's net debt target. This means that, for Budget 2018 and future Budgets, there will be a greater focus on identifying baseline reprioritisation options for low value activities and those not aligned with Government priorities.*

4. The Treasury provided advice [TR2017/2576] which outlined a two phase process for reprioritisation to which you agreed:

   - Phase 1: Immediate savings for Budget 2018 and discrete savings that could be progressed in near-to-medium-term; and
   - Phase 2: Targeted in-depth review of core policy settings driving material costs.

5. The Minister of Finance has written to portfolio Ministers requesting they identify spending reprioritisation options for Budget 2018. Ministerial responses are due by 26 January 2018.

6. In the meantime, the Treasury has undertaken an internal exercise to identify potential savings for phase 1 and likely areas for in-depth review through phase 2. We have also identified potential options for increasing revenue and these are discussed in the second section of this report.

Phase 1: Specific near-term savings options (initial Treasury assessment)

7. The attached appendix provides a detailed breakdown of potential phase 1 reprioritisation options. Table 1 below provides a summary. All figures shown relate to potential savings over the forecast period (2017/18 to 2021/22, i.e. not annual figures). Initiatives are categorised as low, medium or high risk:

   - low-risk initiatives are discrete options that can be implemented quickly with relatively few trade-offs;

   - moderate-risk initiatives are generally those involving low value-for-money expenditure but where the trade-offs are more significant or depend on policy decisions;

- high-risk initiatives are those where the trade-offs seem particularly challenging, or where reprioritisation would be at odds with manifesto commitments or stated government policy.

Table 1: Summary of phase 1 savings options (initial Treasury assessment)

[33]

8. Some of the larger potential reprioritisation options are related to, and dependent on developments in, new and/or upcoming government policies. This applies particularly to housing, tertiary education and irrigation. The following paragraphs discuss these linkages, as well as commenting on some of the other significant savings options. Comments on all the identified initiatives can be found in the appendix.

Housing[1]

9. Consideration should be given to whether existing, low-value housing-related expenditure can be reprioritised to support KiwiBuild or other ways of supporting affordable homeownership, and/or reprioritised back to the centre. In particular:

- [33]
-

[1] The Treasury has provided the Minister of Finance with further advice on managing fiscal pressures in the housing sector (T2017/2512 refers).

[33]

Tertiary Education and Education

10. Given the Government's fees-free tertiary policy and increases to student support, there may be scope to reallocate some of the existing funding aimed at increasing access to tertiary education. The following could be considered for partial reprioritisation:

[33]

11. [37]

12. In addition, there is a range of relatively small but mostly low-risk and discrete savings options in Vote Education (see appendix for details).

ACC

[33]

2 'Non-earners' are people not in the paid workforce, including older people, children and visitors to New Zealand. ACC claims for non-earners' injuries are funded by the Crown. Other ACC claims are funded from levies.

[33]

17. Both types of grant are of questionable value for money and could be considered for reprioritisation. You should note, however, that the Government has indicated its intention to retain these grants to ensure they remain internationally competitive. Abolishing the grants would involve some risk of negatively affecting the film industry, as international demand is reliant on the NZSPG International incentive and domestic film production at current levels wouldn't be viable without the NZSPG Domestic.

[33]

21. [33][34]

22. There is $40 million in the forecast period for funding Limited Service Volunteers (LSV). LSV lacks demonstrated effectiveness and has questionable value for money. However, the Government has committed to expanding LSV and so stopping it is considered high risk.

Regional / industry funding pools

23. There are several pots of funding related to regional economic development that could be considered for reprioritisation. We have provided you advice on potential sources of funding for the Provincial Growth Fund (T2017/2642). This indicated that consideration could be given to whether the funding identified below should be scaled, redirected to the Provincial Growth Fund, and/or reprioritised back to the centre:

- *Primary Growth Partnership ($45 million)*, for co-funding primary sector research and development. This fund is consistently underspent by ~20% and the balance has historically been used for Ministry for Primary Industries cost pressures.

- [33]

- [37]

- *Irrigation ($96 million)*. The Government has committed to reducing Crown Irrigation Investments while honouring existing commitments. The level of saving is dependent on what the Government considers an existing commitment. For the purposes of this exercise we assume $50 million (roughly half of the remaining $100 million in uncalled capital) could be reprioritised. There is also a further $46 million appropriated in Irrigation Grant Funding for irrigation scheme proposal development that could also be considered for reprioritisation (in line with Government policy).

24. [33]

NZ Inc. Offshore

25. Up to $102 million over the forecast period could potentially be saved if recently established overseas posts were closed. However, doing so carries significant diplomatic risks.

Potential options to increase revenue

26. A number of potential revenue raisers have also been identified. As noted above, further work would be needed if you wanted to progress any of these.

Tax

27. In general, raising tax revenue imposes higher welfare costs – but less so when raising revenue through base broadening than through rate increases. The Tax Working Group will consider options for extending GST to low value imported goods (which would raise tens of millions per year) and may also recommend base broadening measures in relation to capital investments and environmental taxes. [33]

28. There are other tax options that could have the potential to be welfare-enhancing, but which would need further work before we would recommend them, such as increasing alcohol excise. Beyond these, there are options that are likely to be welfare-reducing, and if you wanted to explore these we would recommend considering the least distortionary ones, such as introducing a land tax.

Transport

29. The government is committed to fund $2 billion in transport initiatives over the forecast period, which could be funded through National Land Transport Fund (NLTF) revenues, reducing required contributions to transport. These include $1.7 billion for the City Rail Link, $123 million for Regional State Highways, $144 million for SuperGold Card public transport concessions, and $55 million for the Urban Cycleways Fund. Alternatively, some of these initiatives and others identified by the Treasury could be scaled back or ended.

30. If some of these projects are funded by the NLTF, subject to NZ Transport Agency reprioritisation, increases to the fuel excise duty (FED), road user charges (RUC) and other sources to fund the National Land Transport Programme (NLTP) would be necessary. FED was last increased in 2015 resulting in a general revenue boost of $40-50 million per 1 cent increase. The FED is currently 60 cents per litre. Increasing FED and RUC would enable greater transport investment through the NLTP, reducing required Crown contributions to transport and enabling reprioritisation of funds.

31. Increasing FED and RUC should be considered in the context of its potential inflationary implications across the economy.

Energy

32. Royalty settings within the Crown Minerals regime could be adjusted to generate increased revenue. The impacts that such changes would have on investment incentives and corresponding demand should be considered.

Phase 2: Reviewing core cost drivers (initial Treasury assessment)

33. [33]

[40]

[40]

[40]

[40]

[40]

Next steps

60. There is no immediate further action required for now. The Treasury will liaise with your office in the first instance to advise on managing and reviewing the Ministerial reprioritisation responses due by 26 January 2018.

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[33]

[33]