The Treasury

Budget 2018 Information Release

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Investment Ministers

Budget 2018 Capital Initiatives

12 March 2018

Purpose

The key objectives for this meeting are to:

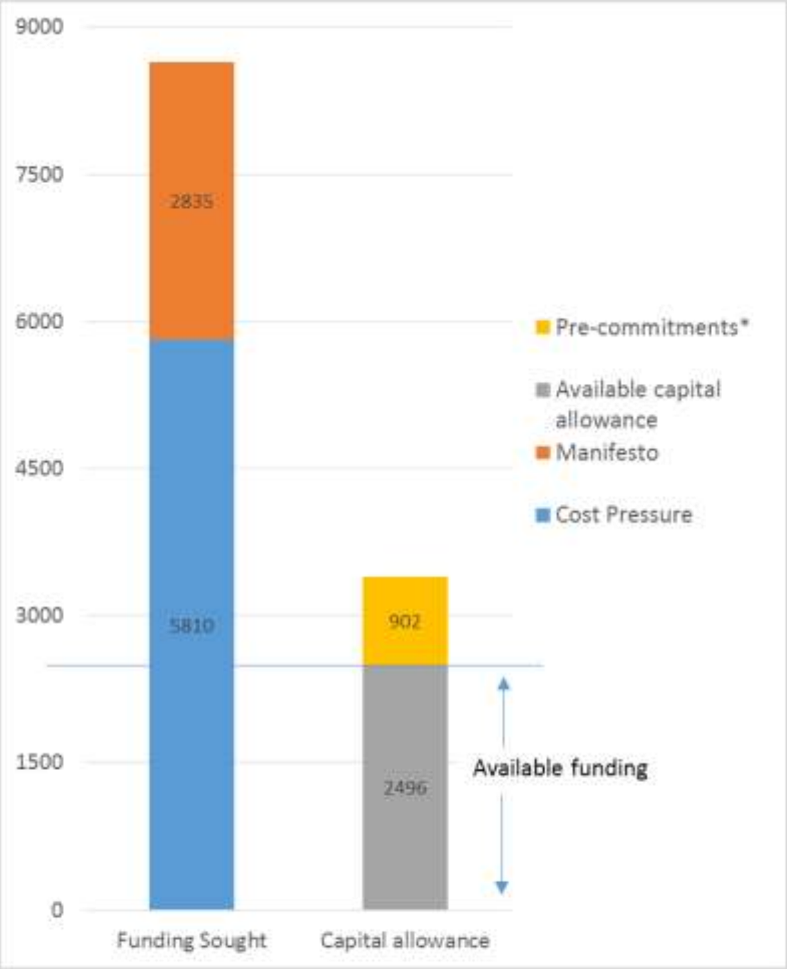
- Provide an overview of submitted Budget 2018 capital initiatives.
- Assist in the prioritisation of the capital package.
- Consider options to provide additional funding for Budget 2018 capital investment.

The Investment Ministers discussion will feed into the draft Budget packages being considered at Budget Ministers 2 on Monday 19 March.

Contents

1) Overview of Budget 2018 Capital Initiatives

Figure 1: Total capital initiatives compared to the capital allowance



Overview

- Figure 1 provides an overview of submitted capital initiatives compared to the capital allowance.
- A total of $8.645 billion in capital expenditure is being sought in Budget 2018.
- This is made up of $5.810 billion in cost pressure initiatives and $2.835 billion in manifesto initiatives.
- After factoring in pre-commitments the remaining capital allowance is $2.496 billion.
- This level of oversubscription is broadly consistent with previous Budgets.
- Attached to this slide pack is a list of all initiatives seeking capital funding in Budget 2018 (Annex 1).

* Pre-commitments are initiatives that have been agreed to by Cabinet outside of the Budget process. The fiscal implications are counted against the Budget allowance. The capital pre-commitments are listed in Annex 1.

1) Overview of Budget 2018 Capital Initiatives

Table 1: Total capital funding sought by portfolio

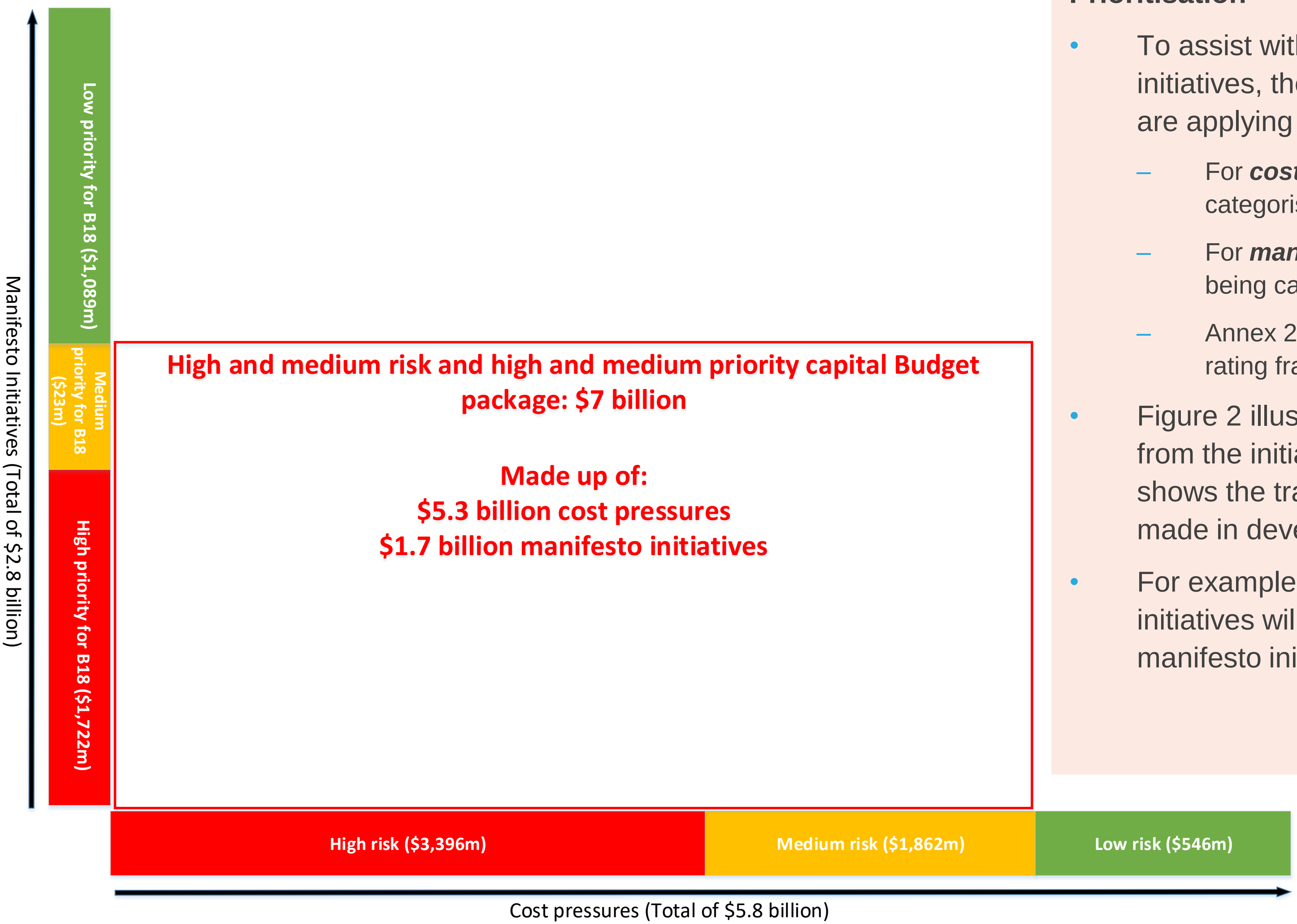
[33]

Overview

- Table 1 lists capital funding sought by Portfolio.
- The main drivers are:
  - ***Defence:*** [33]
  - ***Regional Economic Development (Provincial Growth Fund):*** [33]
  - ***Health:*** [33]
  - ***Education:*** [33]
  - ***Housing and Urban Development:*** [33]
  - ***Corrections:*** [33]

2) Budget 2018: Prioritisation

Figure 2: Treasury Capital package prioritisation diagram*



** Low risk and low priority also include out of scope initiatives.*

Prioritisation

- To assist with prioritisation of capital initiatives, the Treasury have developed and are applying a RAG rating framework:
  - For ***cost pressures***, each initiative is being categorised by risk.
  - For ***manifesto initiatives***, each initiative is being categorised by manifesto priority.
  - Annex 2 provides more detail on the RAG rating framework and process being used.
- Figure 2 illustrates the high level results from the initial prioritisation exercise. It shows the trade-offs that will need to be made in developing the capital package.
- For example, funding more cost pressure initiatives will come at the expense of manifesto initiatives.

2) Budget Prioritisation

For Discussion:

- What areas should be prioritised in Budget 2018?
- What initiatives should be considered for prioritisation?
- What initiatives should be considered for de-prioritisation?

3) Providing additional funding Budget 2018 capital investment

Table 2: Options to additional funding for Budget 2018 capital investment

Option	Description	Implications
1) Scaling and deferring high risk/high priority and medium risk/medium priority initiatives.	Using the Treasury prioritisation of initiatives as a starting point for identifying risks and trade-offs, detailed advice on selected initiatives can be provided to determine what initiatives should be prioritised and deprioritised.	**Pro:** free up funding for higher priority investments. **Con:** this would involve not funding certain initiatives with service delivery risk and reputational risk for departments/Ministers.
2) Rephase allowances to accommodate the Provincial Growth Fund (PGF) Investment.	Currently the full amount of capital for the 3-year PGF is counted against the capital allowance. Consider reducing the B19 and B20 capital allowances, and increase the B18 allowance by a subsequent amount.	**Pro:** this would free up funding for capital investment in Budget 2018. **Con:** this would reduce future capital allowances.

Discussion Point: Ministers may wish to discuss the pros and cons of pursuing the above options to free up additional capital funding for Budget 2018.

3) Providing additional funding Budget 2018 capital investment Cont'd

Table 2 cont'd: Options to additional funding for Budget 2018 capital investment

Option	Description	Implication
3) Reprioritise from the operating allowance.	Reduce the operating allowance to free up capital funding.	**Pro:** this would free up funding for capital investment in Budget 2018. **Con:** the operating allowance is oversubscribed (but not to the same magnitude as capital) so trade-offs would still need to be made.
4) Increase the Capital allowance.	A straight increase in the capital allowance, not reducing expenditure elsewhere. More detailed advice on this option and it's implications can be provided.	**Pro:** free up capital investment by the amount the allowance is increased **Con:** reduces fiscal headroom and increases the risk of not meeting the Budget Responsibility Rules. Impacts credibility of the allowances.

Discussion Point: Ministers may wish to discuss the pros and cons of pursuing the above options to free up additional capital funding for Budget 2018.

4) External constraints

- Affordability is not the only constraint on government investment. Market capacity limits our ability to deliver, at present most obviously in infrastructure and/or construction.
- Pushing capacity/requiring fast growth could increase investment risks in terms of quality, health and safety and sustainability.
- Though our data is limited, we can see a large number of projects that could make use of infrastructure/construction firms. Around ~65 high-value ($10m+) vertical construction projects are underway or expected to begin between now and 2023.
- There are ~120 further projects forecast to begin within 5 years that do not yet have an estimated cost, or are estimated to cost less than $10m, which could also be impacted by increased costs in the supply chain and/or labour shortages.
- It is likely that Ministers will need to consider a combination of interventions including:
  - Attracting more international participants to our market
  - Developing local market players
  - Deferring projects to ensure ambition does not exceed/outpace market capacity
  - Active sequencing and prioritisation across Government investments
- You may also wish to consider:
  - Accelerating/expanding existing efforts to improve data quality to help provide greater confidence and better package up opportunities to attract international participation in our bidding processes
  - The Health sector is projecting substantial construction activity (48 projects with an estimated total cost of $66b in the next 5 years). The investment has the scale to benefit from aggregating projects (to attract more internationals), sequencing, and reuse of design.

5) Beyond Budget 2018

- Affording capital requests in Budget 2018 is part of a broader issue; the pipeline suggests affordability will be difficult for many years (and budgets) to come, driven by:
  - The need to replace ageing infrastructure
  - Current policy settings
  - Increasing population and demand pressures
  - Unfunded capital requests from previous budgets
- A range of options can be considered to address these pressures, including:
  - Changing policy settings to reduce funding demand*
  - Reprioritising investment to areas of greatest need
  - Reorganising services to deliver more efficiently
  - Using long term investment plans to sequence investments and match demand with market supply
- To enable full exploration of these options, agencies will first have to provide better early visibility to be specific of long term investment plans and intentions.

(Future) Discussion Point: Ministers should consider options to address capital pressures beyond Budget 2018 at future meetings.

*Policy setting reviews, such as the Defence White Paper review, may result in capital savings

6) Next Steps

Budget 2018

- Priorities identified in this meeting will be considered in the draft Budget packages being discussed at Budget Ministers 2 on **Monday 19 March.**
- Revised draft packages will be circulated ahead of the second round of Budget workstream meetings beginning **Tuesday 20 March.**

Annex 2: Summary of the RAG ratings

Cost Pressure Prioritisation

- **High risk –** If the initiative is not funded, there may be a breach of legislation or obligation/reputational risk, and there may be operational failure for the department; AND the impact will be felt in the 2018/19 financial year.
- **Medium risk –** if the initiative is not funded, there may be service delivery and/or operational risks to the department; AND some components could be deferred to Budget 2019.
- **Low risk –** if the initiative is not funded, there may be a policy impact with minimal/manageable service implications; and/or can defer to Budget 2019.
- **Potential additions -** Out of scope initiatives that are either: *A Ministerial priority; Have risk of not funding; or have merit.*

Manifesto Initiative Prioritisation

- **High priority –** Mentioned specifically in the Coalition Agreement (CA), Confidence and Supply Agreement (CSA), or Speech from the Throne (ST); AND is Consistent with Priority Areas identified by Budget Ministers; AND will be implementation ready by 1 July AND costings are accurate.
- **Medium priority –** Mentioned in the CA, CSA or ST; AND is consistent with priority areas outlined in the Budget Policy Statement; AND will be implementation by 1 July or within the next 6 months.
- **Low priority –** Not mentioned in the CA, CSA or ST; may still be aligned to priority areas. Likely Treasury recommendation is to defer to future Budgets once costings are complete and the initiative is implementation ready.
- **Potential additions -** Out of scope initiatives that are either: *A Ministerial priority; Have risk of not funding; or have merit.*