

The Treasury

Public Finance System Modernisation – Proposed Work Programme Information Release

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Chair
Cabinet Economic Development Committee

Public Finance System modernisation - proposed work programme

Proposal

1. In May 2018, the Cabinet Government Administration and Expenditure Review Committee (GOV) invited me to submit a paper to GOV by April 2019 seeking approval to formally initiate a review of the Public Finance Act 1989 (PFA) [GOV-18-MIN-0012.01 refers].
2. This paper seeks agreement to a work programme to review and modernise the public finance system. I am proposing a review of the public finance system, rather than just the PFA, because many important components of the public finance system are non-legislative. These include rules and incentives that drive how the system operates.

Executive Summary

3. At a very high level, my vision is for a public finance system that enables the public service to improve the intergenerational wellbeing of New Zealanders.
4. The current system has managed to achieve effective centralised control of the fiscal position (meeting fiscal targets) while devolving to officials the authority and responsibility to manage within a relatively certain funding profile (achieving devolved performance management). It has a high level of transparency and accountability by international standards. We need to hold on to the elements of the system that are strengths.

5. We also need to look to the future and ensure that the public finance system actively supports attention on a wider range of outcomes. I would like the public finance system to reinforce a focus on:
 - **Value creation:** considering the creation and safeguarding of value, while maintaining a focus on fiscal responsibility;
 - **Collaboration:** supporting better system collaboration where appropriate;
 - **Smart regulation:** fit-for-purpose system settings including those relating to strategic planning and reporting;
 - **Long-term resilience:** greater emphasis on the long-term to support innovation, management of assets, understanding of the risks at a system level and capability-building; and
 - **Innovation:** less risk aversion and more rapid responses by the public sector to issues and challenges.
6. The proposed work programme focuses on two key elements of the public finance system:
 - Fiscal management – through better understanding the value of spending and streamlining the Budget cycle; and
 - Financial management and accountability – through smarter regulation of strategic planning and reporting, to improve collaboration and performance.
7. I intend to progress the work programme in two tranches. An initial tranche of less complex and non-legislative changes can be decided and implemented next year. A second tranche of more complex changes (some of which may require change to the PFA) would be decided and implemented in 2021 and 2022.

Background

8. The State Sector Act 1988, PFA, State Owned Enterprises Act 1986 and Crown Entities Act 2004 form our cornerstone legislation governing the establishment, organisation, operations, relationships and accountabilities of agencies in the state sector.

9. The PFA is largely focused on the interaction between Parliament and the Executive, including the financial powers that Parliament confers on the Minister of Finance. For example it requires that on Budget Day, the Executive presents to Parliament its requests to authorise spending¹ and in return provides certain information in support of those requests.² I do not propose to change the nature of this interaction.
10. However, I do see opportunities to shift the system to put people's wellbeing and the environment at the heart of our policies, facilitate greater collaboration to achieve outcomes for people and to be more transparent about the wider impacts of our fiscal choices.
11. Public finances are one of the key resources that the Government uses to improve the wellbeing of current and future New Zealanders. The public finance system describes how the Government uses and controls public resources and what it achieves with those resources. It is made up of:
 - **Principles and strategy.** These form the overarching framework for how we think about fiscal sustainability and the overall health of the system, and therefore how we manage public finances. There are statutory principles of responsible fiscal management and a requirement for the Government to develop a fiscal strategy consistent with those principles and then communicate this annually through the Budget Policy Statement and the Fiscal Strategy report.
 - **Fiscal management.** This is the set of self-imposed processes that help the Government to achieve its fiscal strategy. It includes the Budget process, analysis to support spending decisions, budget allowances, fixed nominal baselines³ and coordination of fiscal and monetary policy.
 - **Financial management and accountability.** These are technical 'rules' that provide transparency and accountability for how public money is spent. They include Votes, appropriations, planning and accountability reporting requirements, including performance measures and Estimates of Appropriations. Some of these are specified in legislation.

1 The Appropriation (Estimates) Bill for the financial year about to start and the Appropriation (Supplementary Estimates) Bill for the financial year about to end.

2 This includes the Fiscal Strategy Report, Budget Economic and Fiscal Update, Summary of Initiatives, Estimates for the financial year about to start, and Supplementary Estimates for the financial year about to end.

3 Fixed nominal baselines means the amount of funding an agency receives each year (the baseline) does not automatically increase to adjust for inflation. Instead agencies are expected to absorb price increases; in effect this acts as an annual efficiency dividend on government expenditure.

12. The reforms of the 1980s replaced an inputs-focused approach with a managerialist, output and performance-focused model based on principles of delegation, accountability and transparency. At the time the PFA was enacted, New Zealand also changed to accrual accounting and adopted financial standards set independently of the government. In the early 1990s, non-legislative fixed nominal baselines were instituted.
13. These changes, in response to the fiscal crises of the late 1980s and early 1990s, placed New Zealand at the reform frontier of like-minded nations. Over the last 30 years many OECD nations have adopted, in part or in full, these reforms. The global financial crisis has sparked further reforms, with many European countries reforming their budgetary processes to address their fiscal crises.
14. While there has been benefits in the approach taken, after 30 years it is clear that there are limitations and perverse incentives in the public finance system that work against achieving long-term wellbeing outcomes. These include the short term focus of Budget processes, 'silo' behaviour and thinking, and over burdensome planning and accountability requirements.
15. Instead of adding yet more requirements to the system, it is now time to re-think our approach to public financing – alongside the State Services Commission's current and important state sector reform work – to support a more modern, agile, flexible, innovative, and joined-up public sector.

Vision for the public finance system

16. The current public finance system has managed to achieve effective centralised control of the fiscal position (meeting fiscal targets) while devolving to officials the authority and responsibility to manage within a relatively certain funding profile (achieving devolved performance management). It has a high level of transparency and accountability by international standards. We need to hold on to the elements of the system that are strengths.
17. We also need to look to the future and ensure that it actively supports attention on a wider range of outcomes. At a very high level, my vision is for a public finance system that enables the public service to improve the intergenerational wellbeing of New Zealanders. I want to see a public finance system that reinforces a focus on:
 - **Value creation:** considering the creation and safeguarding of value⁴, while maintaining a focus on fiscal responsibility;

⁴ Value is the impact on New Zealanders' lives and New Zealand. This covers the broad difference a policy or intervention makes beyond how much it costs.

- **Collaboration:** supporting better system collaboration where appropriate;
 - **Smart regulation:** fit-for-purpose system settings including those relating to strategic planning and reporting (appreciating the underlying tensions in the incentives between accountability, transparency, and performance improvement);
 - **Long-term resilience:** greater emphasis on the long-term to support innovation, management of assets, understanding of the risks at a system level and capability-building; and
 - **Innovation:** less risk aversion and more rapid responses by the public sector to issues and challenges.
18. I want the public service to be smarter and more flexible in how it applies our core principles of parliamentary authorisation, accountability and transparency under different circumstances.

Issues and opportunities to address in the proposed work programme

19. I propose to explore opportunities for improvement in each of the three elements of the public finance system.
- A. *Principles and strategy – Broadening the fiscal framework to shift the system more towards value creation and greater long-term resilience***
20. The PFA and Budget documents currently focus heavily on fiscal objectives and fiscal aggregates. Work is already underway to embed wellbeing in the PFA, by introducing requirements for the Government to report annually on wellbeing objectives, and for the Treasury to report periodically on current and future wellbeing (at least every four years). The PFA has already been amended to include the requirement to report on the government's progress in reducing child poverty (as per the Child Poverty Reduction Act). These legislative changes will help to shift the focus towards other factors that are taken into account in the framework for decision-making.

B. Fiscal management – Better understanding the value of spending and streamlining the Budget cycle

21. The current fiscal management arrangements are based around a budget cycle focused on the annual increment in spending (budget allowances). The result is that a lot of time and effort is spent at the margin, and Budget Ministers engage at a granular level (bid by bid) rather than strategically. Conversely, little time is spent analysing baseline expenditure. The annual budget process can also inhibit medium-term planning since it makes it harder for agencies to get certainty about their funding path. There is an opportunity to refocus fiscal management on the medium-term, rather than short-term planning and decision-making, while still retaining opportunities for public engagement.

C. Financial management and accountability – Smarter regulation of strategic planning and reporting, to improve collaboration and performance

22. We have high transparency for whether public money is being spent within the boundaries authorised by Parliament (appropriations). However, reporting has been much less effective than envisaged in explaining how the spending contributes to outcome-level priorities or promoting more efficient and effective use of that money. The statutory and other rules about financial management result in a large amount of detailed information (for example, in the Estimates documents) which are not particularly accessible and may not be the best way to support Parliamentary scrutiny of the Executive. We can also lose sight of the outcomes of particular investment decisions including the ability to communicate success or learn across the system.
23. The current financial and vertical accountability structures are good for delivering discrete, tangible outputs by a single agency but can create a barrier to helping those with complex needs and tackling complex issues that fall across agency boundaries. Over the last 30 years there have been various attempts to break down “silos” in government, but they remain entrenched in part due to the incentives created by the public finance system. The system is also cluttered with a range of planning and reporting requirements that have increased over the past 25 years and generate compliance costs for agencies.

Timing of policy development and decisions

24. I intend to progress the work programme in two tranches:
- An initial tranche of less complex and non-legislative changes that can be decided and implemented next year.
 - A second tranche of more complex changes (some of which may require legislation) to be decided and implemented in 2021 and 2022.
25. To successfully implement system change, we will also need to consider the behaviours, practices and incentives that are influenced by the system rules and processes. This includes considering whether government has appropriate capability and capacity to implement changes, and how best to improve this. One way of understanding these dynamics better is to pilot changes and review progress before making any system-wide changes, as with the baseline review of the Ministry of Social Development.

Tranche 1: priority work able to be delivered in early 2020

26. I propose to progress the first steps to improve all elements of the public finance system. This will include:
- A. **Principles and strategy** – work already underway to embed wellbeing in the PFA.
 - B. **Fiscal management** – better understanding the value of baseline spending, such as another baseline review.
 - C. **Financial management and accountability** – investigating further some relatively straightforward changes to increase financial flexibility and reduce compliance costs for agencies reporting to the Treasury ^[33]
as well as potentially looking at some simple options to support innovation and collaboration. This work will also include piloting a fundamentally different approach to strategic planning and reporting, as well as the way we develop and agree shared expectations and priorities.
27. I intend to commission a further baseline review in the next few months. The outcomes of the review will be available for Budget 2020. I will report to GOV by August 2019 with initial proposals for potential changes to the financial management and accountability settings. Some of these may have fiscal impacts that will need to be considered before decisions are made.

Tranche 2: priority work able to be delivered in 2021 and 2022

28. This tranche includes further investigation of more complex policy options, such as:

- B. **Fiscal management** – Regular reviews of the largest baselines, setting multi-year funding paths for those agencies,^[33]

We could also

investigate changes to the Ministerial budget process (such as programme budgeting, which allocates funds to objectives rather than agencies) and develop a tool or framework to help agencies prioritise their spending.

- D. **Financial management and accountability** – Opportunities to simplify the system where appropriate, better incentivise a focus on value (particularly of baseline expenditure), better support strategic, medium-term planning by agencies and Ministers, reduce compliance costs, and provide more meaningful information to Parliament and the public. This could include consideration of options to reduce the number and structure of Votes, and adjusting statutory reporting requirements.

29. It is in these areas where we see the greatest opportunities to enable a stronger focus on value creation, longer-term thinking and collaboration. We also aim to reduce the administrative burden on agencies through smarter regulation to free up more space for innovation.
30. During the detailed policy development stage, the Treasury will work with agencies to understand how much work is involved in the change process and how quickly these changes could be implemented. I expect to be able to report to GOV on non-legislative changes, and the timing for their implementation, by April 2020.
31. ^[33]

Related work

32. The **Reserve Bank of New Zealand (RBNZ) Act review** will recommend enhancements to the regulatory framework for managing a banking crisis. Providing tools that avoid the need for taxpayer support is a key objective, but there may be situations where recourse to public funds could be necessary and in the public interest when other options are exhausted. The public finance system review will give effect to any decisions from the RBNZ Act review on providing a permanent legislative authority for drawing on public funds in a financial emergency.

33. ^[33]

34. The Treasury is developing a work programme to **improve the management of critical assets** across government. This will take account of the links between services and the assets critical to delivering those services (such as travel times on roads) or enabling delivery of these services (such as education outcomes and school buildings).

Consultation

35. The State Services Commission was consulted on the proposed work programme in this paper. The Department of the Prime Minister and Cabinet was informed.

36. An early draft of the proposed work programme was shared with the Public Finance Reform group of public service chief executives. They broadly supported the vision, and the direction and need for change.

Financial Implications

37. There are no financial implications arising from this paper. Some policy options that I propose to explore in the work programme may have financial implications. These will be advised when policy decisions are sought.

Human Rights

38. There are no human rights implications arising from this paper or proposed work programme.

Legislative Implications

39. ^[33]

Regulatory Impact Analysis

40. A regulatory impact analysis (RIA) is not required. RIAs will be completed if appropriate before policy decisions are sought.

Gender Implications

41. There are no gender implications arising from this paper.

Disability Perspective

42. There are no implications for people with disabilities arising from this paper.

Publicity

43. I intend to include comments about reviewing the public finance system as part of Budget Day announcements.

44. If the policy work recommends legislative change, I will bring a draft discussion document to support public consultation to GOV in early 2020. Final policy decisions would be sought in the next term of government.

Proactive Release

45. I proposes to release the paper proactively, subject to redaction as appropriate under the Official Information Act 1982.

Recommendations

46. The Minister of Finance recommends that the Committee:

- 1 **note** that in May 2018, the Cabinet Government Administration and Expenditure Review Committee (GOV) invited the Minister of Finance to submit a paper to GOV by April 2019 seeking approval to formally initiate a review of the Public Finance Act 1989 (PFA) [GOV-18-MIN-0012.01 refers];
- 2 **note** that the public finance system is made up of a mix of legislative and non-legislative requirements frameworks, processes and rules;
- 3 **agree** that the public finance system should be modernised;
- 4 **note** that New Zealand's public finance system has a high level of transparency and accountability by international standards that needs to be maintained;

- 5 **agree** that the public finance system should actively support a wider range of outcomes to improve intergenerational wellbeing, including a focus on:
 - 5.1 **Value creation**: considering the creation and safeguarding of value, while maintaining a focus on fiscal responsibility;
 - 5.2 **Collaboration**: supporting better system collaboration where appropriate;
 - 5.3 **Smart regulation**: fit-for-purpose system settings including those relating to strategic planning and reporting (appreciating the underlying tensions in the incentives between accountability, transparency, and performance improvement);
 - 5.4 **Long-term resilience**: greater emphasis on the long-term to support innovation, management of assets, understanding of the risks at a system level and capability-building; and
 - 5.5 **Innovation**: less risk aversion and more rapid responses by the public sector to issues and challenges.

Tranche 1: priority work able to be implemented in 2020

- 6 **note** that work already underway to embed wellbeing in the PFA will help to broaden the basis for decision-making in the public finance system;
- 7 **note** that the Minister of Finance, together with the relevant appropriation Ministers, will commission another baseline review, and that the outcomes of that review will be available for Budget 2020;
- 8 **invite** the Minister of Finance to report to GOV by August 2019, with initial proposals for:
 - 8.1 piloting a fundamentally different approach to strategic planning and reporting;
 - 8.2 potential changes to increase financial flexibility and reduce compliance costs for agencies reporting to the Treasury; and
 - 8.3 options to support innovation and collaboration.

Tranche 2: priority work able to be implemented in 2021 and 2022

- 9 **invite** the Minister of Finance to report to GOV by April 2020 with recommended changes to the fiscal management approach (including the Budget process) and financial management and accountability settings;
- 10 [33]
- 11 [33]
- 12 **note** that if the Cabinet Economic Development Committee agrees to the proposed work programme, the Minister of Finance include comments about reviewing the public finance system as part of Budget Day announcements.

Hon Grant Robertson
Minister of Finance

Date: 02 May 2019