The Treasury

Budget 2020 Information Release

July 2020

This document has been proactively released by the Treasury on the Treasury website at

https://treasury.govt.nz/publications/information-release/budget-2020-information-release

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[1] 6(a) - to avoid prejudice to the security or defence of New Zealand or the international relations of the government

[2] 6(b)(i) - to avoid prejudice the entrusting of information to the Government of New Zealand on a basis of confidence by the Government of any other country or any agency of such a Government

[5] 6(d) - to prevent endangerment of the safety of any person

[9] 6(e)(iv) - to prevent serious damage to the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the stability, control, and adjustment of prices of goods and services, rents, and other costs, and rates of wages, salaries, and other incomes

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[26] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied

[29] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[42] 18(d) - information is already publicly available or will be publicly available soon.

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

Copyright and Licensing

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Further advice on the fiscal strategy

Date:	26 September 2019	**Report No:**	T2019/2887
		File Number:	MC-1-5-2 (Fiscal Strategy)

Action sought

	Action sought	Deadline
Minister of Finance Hon Grant Robertson	**Agree** to recommendations and discuss with officials at Budget Matters on 30 September	Monday 30 September

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Angus Hawkins	Senior Analyst, Macroeconomic and Fiscal Policy	s9(2)(k)	n/a (mob)	✓
Tamiko Bayliss	Acting Manager, Macroeconomic and Fiscal Policy		s9(2)(g)(ii)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: No

Executive Summary

This report provides detailed advice on fiscal stimulus options in the current macroeconomic environment and follows our previous fiscal strategy advice of 4 September [T2019/2447].

Economic growth has weakened slightly since Budget, but we continue to view a major downturn as unlikely, and economic growth as near potential.

While the global economic outlook remains uncertain, data is consistent with the view in our previous advice. Growth has slowed, but remains positive. The labour market remains tight and spare capacity remains low in most sectors. Global economic risks and domestic uncertainty may be weighing on investment, although the Reserve Bank's loosening of monetary policy should help the domestic economy.

The primary macroeconomic concerns, in the short-run, remain persistently low confidence (and its effect on investment); and the limited space for monetary policy to respond to any future weakening. We do not see any proximate cause for a recession or major fall in demand. Short of a major international shock, there are no 'trigger points' that we expect to change this view between now and the Budget Policy Statement.

Consequently, the case for a short-term stimulus aimed purely at stoking demand is weak; but there is a case for spending to support monetary policy and confidence.

A 'classic' fiscal stimulus would spend money quickly to support demand in the face of an economic shock, aiming to raise activity back to its potential level. Given we are not facing any major shock, the labour market is tight and spare capacity is low, there is no macroeconomic case for a stimulus of this kind.

However, in the current economic context there are benefits to adopting a looser fiscal position. A large increase in spending in the near future will support the Reserve Bank in meeting its objectives, and reduce the risk they need to implement unconventional monetary policy. A commitment to longer term spending could help address business confidence, signalling a future pipeline of government demand. Any increase in spending should also continue to be directed to high value initiatives you would fund in a 'business as usual' world. The overall macroeconomic outlook remains broadly positive, and does not justify sacrificing quality of spend for speed of delivery.

If you wish to pursue a spending package, s9(2)(f)(iv) [redacted] s9(2)(f)(iv) [redacted] ***and a commitment to higher capital spending.***

The full set of spending options we have considered are summarised in the two A3 tables on pages four and five. s9(2)(f)(iv) [redacted]

We also propose a large increase to the multiyear capital allowance. An increase of $10 to $15 billion, to be allocated over the next four years, could be feasible given expected future infrastructure demand. We expect an increase to this allowance would have been required even under 'business as usual' – but announcement of a particularly large commitment will have important confidence effects. We recommend this is also accompanied by a commitment to some specific capital projects, of which road projects will be the easiest to announce within a short timeframe.

We have also considered several short-term or temporary spending options that would be suited to a ‘classic’ fiscal stimulus. However, options of this type are not required in the current macroeconomic context. While many of these initiatives could be funded now, we recommend they are considered as part of the normal Budget process. This will allow for greater scrutiny, and for these options to be weighed against the full set of spending proposals.

s9(2)(f)(iv) [redacted]

Simplistic modelling based on the economic and fiscal forecasts as at Budget 2019 indicates a package of the size recommended above could be consistent with maintaining a prudent fiscal position. However, it would be unlikely to fall within your Budget Responsibility Rules. This early modelling is not a reliable guide to the impact on our final updated forecasts, and the options we have proposed are highly scalable.

We will provide further advice on the overall fiscal strategy, including the level of operating allowances, on 30 October. This will include the impact of any package relative to the preliminary economic and fiscal forecasts. We recommend that you make final decisions on the scale of a package, and whether one is implemented, following that advice. Prior to that advice we will continue developing a package based on your preferred options.

Recommended Action

We recommend that you:

a **agree** to further develop a spending package based on the Treasury’s recommended options s9(2)(f)(iv) [redacted] an increase to the multiyear capital allowance.

Agree/disagree.

b s9(2)(f)(iv) [redacted]

c [redacted]

d **note** you will receive advice on 30 October to support a final decision on the scale of any spending package, following the production of preliminary economic and fiscal forecasts.

Tamiko Bayliss	Hon Grant Robertson
Acting Manager	**Minister of Finance**

s9(2)(f)(iv)

Ref	Short-term projects	Approximate cost ($m), fiscal years 2019/20	2020/21	2021/22	2022/23	Ongoing cost	Cost type	Treasury Appraisal
B1	Road safety improvements	-	200	200	-	No	Capex	**Less preferred.** While this delivers short term capital spending and there are checks in place to ensure projects remain good value funding, we believe long term funding is more appropriate. This also undermines existing funding mechanisms for road improvements.
s9(2)(f)(iv) [redacted]								
B3	Schools property funding							
	Increase to 5YA funding	-	200	200	-	No	Capex	**Less preferred.** Although these options allow for short term capital spending, we do not believe there is a macroeconomic case for this. This may be restricted by capacity constraints, and will have a less immediate effect on monetary policy than changes to household incomes will.
	s9(2)(f)(iv) [redacted]							
s9(2)(f)(iv) [redacted]								
B5	District Health Board asset renewal	-	200	200	-	No	Capex	**Less preferred.** Although these options allow for short term capital spending, we do not believe there is a macroeconomic case for this. This may be restricted by capacity constraints, and will have a less immediate effect on monetary policy than changes to household incomes will.
s9(2)(f)(iv) [redacted]								

Ref	Major capital projects	2019/20	2020/21	2021/22	2022/23	Future cost	Cost type	Treasury Appraisal
C1	Increase multiyear capital allowance		$10 to $15 billion				Capex	**Recommended.** This announcement, alongside commitment to projects below, will signal a commitment to structurally higher levels of capital spending that will provide longer term support to the economy.
C2	Major road projects			Up to 9,000			Capex	
	Penlink	73	26	24	32	293	Capex	**Less preferred.** These are substantial capital projects which are announcement ready. Funding them will likely support business confidence and medium term confidence in the construction sector by providing a forward pipeline of projects. However, funding these will undermine the existing funding mechanism for NZTA, on which you will be received advice on October. We recommend you consider this option only in light of that advice.
	Tauranga Northern Link	5	26	62	149	183	Capex	
s9(2)(f)(iv) [redacted]							Capex	
s9(2)(f)(iv) [redacted]								

Treasury Report: Further advice on the fiscal strategy

Purpose of Report

1. This report provides further detail on the policy options for a fiscal stimulus package. It follows on from our previous fiscal strategy advice [T2019/2447], which advised on the macroeconomic rationale and potential policy options. We will provide further advice on the macroeconomic rationale as part of our fiscal strategy advice on October 30, following the production of the Treasury's preliminary forecasts.

2. The Treasury has worked with agencies to develop the high level policy options presented below. We have assessed these against the requirements of a stimulus package, and recommended a package of options that should be developed further to form the basis of any spending package announced later this year. We are seeking your agreement for this package to be developed further, and other spending options to be ruled out.

3. This report also touches on macroeconomic developments since our last advice, and the implications for whether a stimulus is required. We remain of the view that a final decision on whether a spending package is implemented should be taken with the benefit of formal Treasury forecasts, and alongside setting allowances.

Economic and fiscal outlook

The economic outlook remains similar to our previous advice – growth has weakened slightly, but a recession or sharper slowdown is unlikely.

4. Our previous advice outlined three scenarios we viewed as possible over 2019, shown in Table 1. The economic data released in the last three weeks, in particular the June quarter GDP figures, have been in line with our expectations of slightly weaker growth under scenario 1 (highlighted), and do not support the weaker outlook of scenarios 2 or 3. We increasingly view scenario 1 as the central outcome, with a sharper slowing in growth or a recession unlikely. This view will be reflected in our preliminary economic forecasts.

Table 1: three scenarios for the economy

Scenario	*Economic Outlook*	*Fiscal Outlook*
1	**Slightly weaker growth** – growth for 2019 falls below BEFU forecasts, but remains above 2%. Possibility of a slight rise in unemployment; further cut in the OCR possible but not certain.	Future OBEGAL position likely to be weaker, possibility of deficit in 2019/2020. Impact on net core Crown debt uncertain; lower growth may be offset by the improved fiscal starting point from the previous year.
2	**Much weaker growth** – growth for 2019 drops below 2%. Rise in unemployment; OCR cut further.	OBEGAL deficit more likely than not. Increase in net core Crown debt above level forecast at BEFU likely.
3	**Recession** – growth falls substantially, and looks to turn negative in 2019 or early 2020.	OBEGAL deficit and significant increase in net core Crown debt certain.

	Unemployment rises; OCR reduced rapidly to zero or below.	

5. Consequently, a large fall in demand below its potential level – the usual prerequisite for a fiscal stimulus – is unlikely in the near future. The principal short-term macroeconomic issues are likely to remain:

   - persistently weak business and consumer confidence, which is weighing on investment; and

   - the limited space available to conventional monetary policy to support any future slowing in growth and raise inflation to the midpoint of the target range.

   Increased spending may be an appropriate mechanism to address these issues. However, a stimulus designed to address these will generally require a different design to a fiscal stimulus in response to a recession or falling demand. This is discussed in detail below.

6. You have also received detailed advice on the fiscal position [T2019/2710] based on the unaudited year-end accounts. You will be receiving the final year-end numbers next Tuesday, which have changed slightly from the unaudited results. Particular points worth noting are:

   - That the larger than expected Operating Balance before Gains and Losses (OBEGAL) surplus of just under $8 billion is largely due to one-off items and is not likely to persist in future.

   - There are downside risks to the fiscal outlook as a result of lower interest rates and weaker growth.

   - Net core Crown debt for 2018/19, based on unaudited year end results, is just above 19% of GDP.[1] This is stronger than previously forecast, and provides more space against your Budget Responsibility Rules.

7. Consequently, while the debt position is strong, both with respect to your Budget Responsibility Rules and maintaining debt at prudent levels, the outlook for the surplus is less so. There remains a possibility of an OBEGAL deficit in the forecast period under current spending levels.

8. However, this should not be viewed as a negative macroeconomic outcome, if a deficit is temporary, or driven by cyclical economic factors. We would, in general, still view a one or two year deficit as consistent with a prudent policy, if OBEGAL subsequently returned to surplus. In particular, we would advise strongly against any reduction in spending to maintain an OBEGAL surplus. In the context of weaker growth, we would view a temporary deficit as the fiscal ‘automatic stabilisers’ operating as expected.

We do not expect any substantive new economic data between now and December – the case for a stimulus should be made based on the current outlook.

9. Short of a major international shock, there are no formal ‘trigger points’ we would identify over the next three months that would dramatically alter the case for a stimulus. Economic data should continue to be closely monitored, particularly the Quarterly Survey of Business Opinion released on 1 October, and labour market data on 6 November. However, neither of these data releases are likely to fundamentally shift our view of the economic outlook.

[1] This will be lower than the 19.5% reported in T2019/2710 as it incorporates the June quarter GDP figures released on 19 September; the figure of 19.5% was based on GDP in the year to March 2019.

10. As discussed in our previous advice, the case for any stimulus in the current outlook is likely to come down to judging the balance of risks between the impacts of unconventional monetary policy on one hand; and the risk of a structural budget deficit and low value expenditure on the other hand.

11. Whether a stimulus is required will largely be based on the weight you attach to each of those risks. If you are comfortable with the possibility of the Reserve Bank implementing unconventional monetary policies and highly averse to any deficit, a stimulus would be unadvisable. Conversely, an aversion to unconventional monetary policy and comfort with a temporary deficit, a fiscal stimulus would be advisable.

12. There is not a technocratic answer to this question – it will remain a matter of judgement and risk. As discussed above, we will provide more comprehensive advice to support your decision on 30 October. This will allow us to place these choices in the context of the fiscal forecasts, and therefore illustrate the likely impact of alternative spending decisions of the fiscal position, though the overall impact will remain uncertain. We will also, at that stage, be able to advise further on the likely implications of some unconventional monetary policy options.

Criteria for a spending package

In the current economic context the case for any fiscal expansion will be different from that of a standard 'timely, temporary and targeted' fiscal stimulus.

13. As noted above, there is a limited argument for rapid 'fiscal stimulus' to support falling demand. The macroeconomic case for announcing a spending package outside the normal Budget process will largely rest on the impact on economic confidence and the support provided to monetary policy.

14. It is also possible that, with hindsight, a fiscal expansion in the current context is not required. In this case, we would want to ensure funding was directed to <u>high quality initiatives that address pre-existing policy objectives or economic challenges</u> – i.e. a 'least regrets' approach. Again, this judgement would be different if the outlook were more negative. We would advise strongly against any rush to spend, and support restricting new spending to well designed, high value initiatives.

There are three main risks any stimulus package should avoid – low value spending, generating a permanent deficit, and creating a sense of panic.

15. This advice has been prepared at pace; preparing the policy options discussed below for announcement in December represents a challenging timetable. In that context, without adequate time for policy development, the risk of poor use of public money or poor policy design is enhanced.

16. For this reason, we advise prioritising those spending options, which are part of an existing programme, or where policy design is relatively far advanced. There are several cases discussed below where it would be possible to commit funding now, but we have advised against it. This reflects limited confidence in the agency to spend the money and/or a view that policy proposals are insufficiently developed.

17. The risk of entering into deficit is important to consider. We will be able to advise on it more comprehensively with the benefit of fiscal forecasts in our 30 October advice. However, it should be taken into account when considering whether options have a permanent or temporary fiscal cost. Funding options with permanent ongoing cost, which are difficult to reverse – such as tax or welfare changes – increases the risk of fiscal consolidation being required later in the forecast period to maintain a budget surplus across the economic cycle.

s9(2)(d)

[redacted]

23. Table 2 summarises the above discussion into the set of risks and benefits we have considered in appraising the policy initiatives discussed below.

Table 2: issues considered in appraising policy options

Maximising benefits	***Minimising risks***
Is it a policy where, under a standard analysis, the benefits outweigh the costs? Does it support productivity or address long-run economic issues? Is it likely to improve confidence in the economy? Does it benefit lower income households? Is it likely to support monetary policy by generating domestic inflation?	Is the policy already well-developed? Are we confident the agency can implement in the required timeframe? Does it affect or undermine existing funding mechanisms? Is it temporary spending, or can the spending be stopped in future?

Overview of the proposed package

24. Based on the criteria above, we have worked with agencies to further develop the long-list of policies presented in our previous advice. We have rated each policy red amber and green on the following basis:

- **Green** policies meet most of the criteria summarised in table 2. They directly address the macroeconomic objectives discussed, and we are confident they are positive, long term policy changes with low risk of leading to low value spending.

- **Amber** policies are likely to be ready for implementation by December, and will have some positive stimulatory impact. However, they may have some risks, and may not be initiatives we would usually recommend prioritising outside a stimulus process. You may wish to develop some of these further if you are aiming for a particularly ambitious fiscal expansion, and place a lower weight on the risks described above.

- **Red** policies are those which are underdeveloped and will be difficult to have implementation ready by December; or are of dubious value, with limited evidence to support them. Given the macroeconomic outlook, we would not recommend any of these policies are progressed further at this stage. This will not prevent them being considered as part of Budget 2020.

25. Figure 2 below summarises the set of options we have considered. Sizes are based on the approximate total cost over the four year forecast period, and coloured based on the Treasury's recommendation. Costs for most options are early estimates at this stage, and will be refined further where needed. A detailed year by year costing of each policy options (including options for scaling) is provided on pages four and five.

26. In the Treasury's view, the optimal spending package would consist of:

s9(2)(f)(iv) [redacted]

- A commitment to **future capital spending** through a large increase to the multiyear capital allowance, in conjunction with funding of procurement ready major projects. An increase of $10 billion to $15 billion in the allowance may be feasible, though is subject to a number of risks, discussed below.

27. The recommend options are highlighted in green in the figure on page 11. s9(2)(f)(iv) [redacted]
s9(2)(f)(iv) [redacted]

28. The increase the multiyear capital allowance should be designed so as to support confidence, and give a signal of the Government's commitment to a forward pipeline of capital spending. This should be accompanied by clear communications that explain the implications for infrastructure spending, and encourage agencies to develop and submit bids for long-term, high value capital projects. Further detail is provided in Annex C.

29. The multiyear capital allowance current includes $4.4 billion unallocated to projects to be spent over the next four budgets. We expect this amount would have needed to be increased prior to Budget 2020 in any case. In this sense, the increase proposed above is not strictly 'additional' spend above business as usual – but will still support longer term confidence, and, if well directed, economic growth and productivity.

30. It will also be important that some of the increase in the capital allowance is allocated to projects. Delayed road projects will be the easiest large scale investments to announce at this stage. While we are confident of the value of these proposals, directly funding road projects from the Crown may undermine the existing National Land Transport Fund mechanism. You will be receiving advice on this funding process in October, and we recommend you consider whether to fund these projects in light of that advice.

s9(2)(f)(iv)

[redacted]

31. The options highlighted in amber or red are less suited to inclusion in a spending package in the current economic context. They are less well prepared initiatives, where it is ambiguous if the benefits outweigh the costs. They can be implemented quickly, but present some delivery or policy risks. We would advise placing less weight on

these risks in a sharper recession, but not in the current context. You may still wish to consider these options through Budget 2020.

32. The size of any spending package will be highly variable. The macroeconomic objectives do not dictate a package of a specific size – the goals of supporting monetary policy and economic confidence are open ended, and do not have any ‘target’ we should seek to hit. As such, the size of a package should be dictated by what can be spent while maintaining a prudent fiscal position. Uncertainty in the economic forecasts mean there will be a judgement involved in how much risk you are willing to tolerate, which will inform the size of the package. The macroeconomic impacts and possible package sizes are discussed below based on early modelling – we recommend you consider this in more detail following the finalisation of the Treasury’s preliminary economic and fiscal forecasts, where we will be able to advise on the impacts with greater confidence.

33. We have not considered regulatory policy changes in this advice, and have focused on fiscal measures. Positive regulatory changes where the benefits outweigh the costs should be implemented regardless of the macroeconomic environment and fiscal position. However, any regulatory changes that support economic activity could also be announced alongside a spending package, to support the confidence objectives outlined above.

Macroeconomic impacts

34. Your office have requested advice on the macroeconomic impacts of a spending package prior to the production of our economic forecasts. Economic impact estimates are always highly uncertain. This is particularly the case if impacts are estimated outside our usual forecasting model, and without the benefit of the normal process of review and iteration.

35. The below results are an extremely rough illustration of the impact of the packages discussed above. They include important assumptions that affect the results:

- They are based on our forecasts as of Budget 2019, and do not account for the changes in the economic and fiscal outlook since then.
- Increases in spending affect nominal GDP through an assumed ‘fiscal multiplier’ of 0.6 – so $1 of extra spending increases GDP by 60c in the first year of spending, with the effect fading over time. This assumption is highly uncertain.
- We do not model how far this increase in nominal GDP will increase real GDP, and how far it will be captured in higher inflation.
- We do not model the impact of increased tax revenue from increased GDP, or the other ‘second order’ effects of fiscal expansion.
- The impacts shown will differ from the impact of any spending package in our final forecasts.
- Effects shown are only the temporary effects of increased demand. We make no assumptions about long run increases in productivity from positive structural changes.
- We assume the increased capital allowance is spent to the same time profile as the current level of capital spending. However, a very large increase may require us to revisit this assumption, resulting in the capital allowance having a more delayed impact on GDP and net debt.

36. Overall, we recommend using the estimates below as indicators of the different relative impacts of different packages, rather than measures of their absolute impact. They should not be used a preview of or a substitute for the Treasury's forecasts.

37. We demonstrate three scenarios to give an indication of the economic and fiscal impact of a package:

s9(2)(f)(iv)

[redacted]

- **Capital package:**
    - i Increase capital expenditure by $15 billion over the forecast period

s9(2)(f)(iv)

[redacted]

The results of these on net core Crown debt, OBEGAL and nominal GDP are depicted in the charts on page 14.

38. A few stylised facts can be drawn from the analysis:

s9(2)(f)(iv)

[redacted]

- Any of the packages considered will likely result in missing the Government's 2020/21 debt target – though this may change when the stronger fiscal position discussed in paragraph 6 is accounted for.

s9(2)(f)(iv)

[redacted]

- This modelling does not consider the impact on the Official Cash Rate (OCR). However, in line with our previous advice, a rule of thumb is that a fiscal impulse of 1% of GDP equates to an approximately 30 basis point OCR cut. At peak, the combined package is approximately 2.5% of GDP – or equivalent to 75 basis points. Importantly, we would not expect this to necessarily raise the OCR. It would simply offset cuts that may otherwise happen.

39. We do not recommend 'fine-tuning' a package on the basis of this modelling. However, we can provide alternative scenarios, including alternative long run assumptions, if helpful for deciding on the overall shape of a package.

s9(2)(f)(iv)

Next steps

40. We will be meeting you to discuss this paper on 30 September. Our recommendation is that, subject to our views on the detail of the options, s9(2)(f)(iv) s9(2)(f)(iv) [redacted]

41. Following the production of the preliminary fiscal and economic forecasts, we can proposed scaled versions of these policy options that are consistent with maintaining a prudent fiscal position, and allow you to maintain current operating allowances and an increased capital allowance. This should allow you to make decisions on a final version of these policy options to take to Cabinet in early November.

42. You have previously stated your intention to give an early indication of any spending package alongside the release of the financial statements of government on 8 October. We would advise any such statement take a similar tone to your previous statements on this topic. For example, noting that we are monitoring the economic risks; but that the strong fiscal position may allow more spending than had previously been planned. This signals future spending, but maintains a high degree of flexibility, while avoiding framing spending as a response to a worsening economy.

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

93. The options proposed below are a range of short term spending proposals that can be implemented and delivered within two to three years. We do not recommend advancing any of the below options at this stage due to poor alignment with the macroeconomic objectives of any new spending. While many of these have the potential to be high value initiatives, we recommend they are considered through the normal Budget process. The economic context does not require immediate short term spending at this stage, particularly on options that have not been fully developed.

B1: Road safety improvements

Approximate cost: $400m over two years **Treasury appraisal:** Amber

94. In order to support a stimulus response, the New Zealand Transport Agency (NZTA) has advised that Crown funding could be used to expand the scope of its Safe Networks programme which consists of improvements to existing roads. We understand that these works could be delivered relatively quickly and primarily involve the construction of safety aids such as median barriers and rumble strips.

95. NZTA has identified an indicative package of projects that could be added to the programme worth approximately $604 million, with the majority of this expenditure expected to be incurred over the next two financial years. Under the direction and forecast funding outlined in the Government Policy Statement on Land Transport 2018, these projects would likely have been delivered as part of the next National Land Transport Programme using land transport revenue.

96. These projects have been prioritised by the NZTA based on a number of factors including expected reduction in deaths and serious injuries, and are supported by a Programme Business Case.

97. The list of projects include a mix of urban and regional projects, but is limited to improvements to state highways meaning that no funding contribution from local authorities would be required.

98. If you wish to include these improvement projects in a stimulus package, the amount of funding you could provide is highly scalable depending on the amount of additional capital expenditure you wish to commit to. In the first instance, we would recommend limiting funding to those projects that are ready for implementation, which would involve committing roughly $400 million worth of funding.

99. We note that it would be preferable to provide the NZTA with an envelope of funding rather than directing them to undertake a specific set of projects as the latter option would reduce their flexibility to deliver a package of works quickly. It is likely that an expansion to the scope of the programme could be announced by December 2019 should you agree to progress this option.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

B3: School property funding

Approximate cost: up to $530m over three years **Treasury appraisal:** **Amber**

108. Short to medium term increases in spending can be delivered through funding developments of the education estate. There are three possible mechanisms to achieve this, which are discussed in paragraphs 111 to 116. We view a one-off increase to the Five Year Agreement funding s9(2)(f)(iv) [redacted] in schools as the most appropriate mechanisms.

109. The most substantial risk to this option, common to any delivery mechanism, would be a lack of school or departmental capacity to spend the money quickly. Additional departmental and non-departmental operational funding may be required to support delivery. We will seek to investigate how likely this is in any work developing these options further.

110. As noted above, funding this option should also be viewed in the context of wider capacity constraints. Directing a large volume to funding to short-term maintenance projects in multiple parts of the public estate risks straining the capacity constraints in the construction sector.

One-off/time-limited increase to Five Year Agreement (5YA) funding

111. This would provide all schools with a one-off increase in their 5 Year Agreement funding to use in line with their current 10 Year Property Plans. The purpose of 5YA funding is to fund minor school capital upgrades (e.g. roofing repairs or replacements, extensions or repairs of existing buildings, landscaping or replacing coal burners). The amount of funding provided to schools could range anywhere from $30,000 to $350,000 per school depending on their size and age, leading to between $100 to $400 million total spending over the next two years.

112. This is our preferred school property funding option, as 5YA funding is ring-fenced and monitored. This provides parameters around the types of activities that can be funded. This funding is likely to provide spending distributed across the country, concentrated in areas with larger populations, and provide specific benefits to small, local businesses and trades.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

B5: District Health Board asset renewal

Approximate cost: $200 million per annum **Treasury appraisal:** Amber

125. Providing DHBs with an additional pool of targeted capital funding for minor asset and infrastructure renewal could be an effective fiscal stimulus option that provides relatively “shovel-ready” investment with a broad distribution across major urban and provincial centres. Given the current state of assets and infrastructure, we estimate that an investment of $200 million in 2020/21 could be managed from a procurement and delivery perspective by individual District Health Boards (DHBs) using mostly local or regional market capacity. This could be extended to a multi-year approach dependent on the fiscal position.

126. Once the National Asset Management Plan (NAMP) is completed in December 2019, there will be a common data set across the sector to better inform targeting at a national or local level. Based on the early findings of the NAMP, investment in site wide infrastructure (e.g., pipes, electrical systems, fire separation) will be a priority, to which we recommend funds are tied. This would reinforce the value of the NAMP within the sector and support the resilience of the system.

127. We recommend a proportional allocation based on facility asset values or population served rather than requiring individual business cases for each investment. This would recognize the variable scale of DHB asset bases and local DHB and market capacity. A clear signal at DHB-level of available funding in December would help mitigate the risk of delays in planning and procurement.

128. Ring-fencing of existing minor capital works expenditure or a co-investment model could be considered to ensure that business as usual funding is not diverted, thus reducing the impact of Crown investment. An appropriate reporting and monitoring pathway would be needed and early engagement with the Ministry of Health is recommended.

129. A residual risk of targeted site wide infrastructure investment would be how cost overruns would be addressed where DHBs do not have sufficient funds to complete projects due to costs exceeding project contingencies. This could result in impacts on the health capital envelope or additional deficit support requests, but could be managed through a programme-level contingency held by the Ministry.

B6: Public estate decarbonisation

Approximate cost: Variable **Treasury appraisal:** Red

130. We have consulted MBIE and EECA on the possibility of a state sector specific decarbonisation/energy efficiency fund to rapidly rollout projects which would reduce state sector carbon emissions. However, it appears that there is significant implementation complexity, limited stimulus benefits, and many of the opportunities for decarbonisation overlap with other options being considered in the Education and Health sectors, including:

- Education - one-off / time limited increase to 5YA funding,
- Education - Improving environments in rural or regional schools, and
- Health – Minor asset and infrastructure renewal.

131. The opportunities we investigated focussed on process heat (e.g. boilers and space heating), and energy efficiency measures (e.g. LED lighting, insulation, system

efficiencies). However, these opportunities are typically situation specific and involve complex projects best advanced as part of each hospital or school's wider capital programme. (e.g. replacing a boiler in a hospital generally means also replacing piping, and is best done at the end of the assets' life).

132. These projects are also likely to be slow to rollout. Agencies estimated that from conception to completion, projects would take approximately 2 years and possibly longer if there were limitations on when the installation could happen (e.g. some of this work requires full or partial shutdowns which require planning). The best information to hand also indicated that the number of 'ready to go' business cases for process heat replacements in the public sector is limited.

133. On balance we do not recommend advancing work on a separate fund as part of a spending package. If you wish to support decarbonisation you could indicate to Minister of Education and Minister of Health that they should encourage the sensible prioritisation of efficiency and decarbonisation projects as part of their wider capital investment programmes.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

C1: Increase to the multiyear capital allowance

Approximate cost: $10 to $15 billion increase in allowances; although an increase would have likely been required under business as usual.

Treasury appraisal: Green

141. The multiyear capital allowance (MYCA) currently includes $4.4 billion unallocated to projects over the next four Budgets. This is unlikely to be sufficient to fund 'business as usual' capital spending, and so an increase would be required in any case.

142. Announcing a large increase would provide a clear signal of higher public investment. This would support confidence, and address the medium term macroeconomic issues identified above by, in the first instance, encouraging agencies to develop and bring forward business cases for high quality investment projects; which in turn will provide a forward pipeline of projects.

143. Based on the infrastructure pipeline for the next four years, and including capital initiatives not funded at Budget 2019, we estimate the total capital sought over the next four Budgets to be approximately **$20 billion**. This suggests an increase of around $15 billion, to bring the total MYCA to this level, could be feasible. This increase would be substantially larger than any other capital allowance in recent history.

144. However, the level of the increase is subject to a number of considerations that may support a lower level of allocation:

- Some of the capital initiatives in the pipeline may be low value proposals you would not wish to fund.
- Projects in the pipeline may not be investment ready in the currently expected timeframes.
- Such a large increase may not be viewed as credible given capacity constraints in the economy.
- A large allowance may reduce the fiscal discipline imposed through the Budget process, and weaken the case for ruling out low value initiatives.
- A lower increase (for example, $10 billion) would still send a strong signal of higher public investment and create a capital allowance higher than in recent history.

145. We propose providing more detailed advice on these issues in our next fiscal strategy advice in October, where we will be able to present a range of options for increases to the MYCA.

146. An increase in the allowance alone is unlikely to be sufficient to provide a short term confidence boost. We recommend you also commit funding to some of the investment ready capital projects below, as well as signalling to agencies that substantial capital funding will available over the next four budgets, and initiatives should be progressed accordingly.

C2: Major road projects

Approximate cost: up to $9 billion in total **Treasury appraisal:** Amber

147. The NZTA has also provided a list of larger projects involving the construction of new roads or urban rail improvements which are currently unfunded and could be brought forward using Crown funding.

148. These projects will take longer to deliver compared to safety works in option B1, and the direct stimulatory effects will be limited in the short run with the majority of expenditure expected to be incurred towards the end of the forecast period and beyond. However, using Crown funding to add to the infrastructure pipeline is likely to boost economic confidence, and there will also likely be long-run productivity gains from faster delivery of some of these projects.

149. NZTA have indicated that depending on Minister's objectives, they could prioritise the list of projects in terms of criteria such as net economic benefits or linkages to other Government priorities.

150. At this stage, we understand that Penlink, East-West Link and Tauranga Northern Link are the closest to being ready for delivery and could be advanced relatively quickly if Crown funding were made available. There are initial considerations relevant to each project:

- **Penlink** is technically a local roading project under the control of Auckland Transport. The NZTA could take over the project as a state highway if Crown funding were made available to cover the full cost. However, the Ministry of Transport has advised this could risk setting a precedent for other local road projects and would require reconsideration of the ATAP agreement.

- **Tauranga Northern Link** was in the early stages of procurement before the process was stopped as a result of NZTA's wider re-evaluation of State Highway projects. However, the project may require rescoping before it was progressed in order to deliver a multi-modal transport solution as opposed to the four-lane highway originally proposed.

s9(2)(f)(iv)

151. At this stage, <u>we recommend that you indicate which projects you would like officials to investigate further for faster delivery using Crown funding.</u> Decisions on what projects to include are highly scalable depending on the level of expenditure you wish to signal and commit to, but we consider that the three projects mentioned above would be a good starting point.

152. We note that the Treasury's Infrastructure Transactions Unit (which will form part of the New Zealand Infrastructure Commission upon establishment) has also been considering how to bring forward major transport projects at the direction of Ministers Twyford and Jones. If you agree to explore the option of providing Crown funding for major roading projects, we consider that these two work streams should be integrated and recommend you discuss this with Ministers Twyford and Jones.

153. We note that providing funding for land transport investments outside of the National Land Transport Programme framework is inconsistent with the established funding method based on user-pays principles.

154. In response to a direction from Cabinet, we will shortly be providing you and the Minister of Transport with advice on funding and financing models for the New Zealand Transport Agency. We expect this advice to conclude that the current "pay-go" model (where revenue roughly matches expenditure at any point in time) superior financial disciplines in terms of ensuring value for money as compared to a Crown grant or other arrangements. In considering any potential fiscal stimulus, Ministers may wish to

consider this against the broader macroeconomic benefits provided through additional investment.

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

[redacted]

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)

s9(2)(f)(iv)