

# The Treasury

## Budget 2020 Information Release

### July 2020

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- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
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## Treasury Report: Budget 2020 Draft Cost Pressure Packages

<b>Date:</b>	29 November 2019	<b>Report No:</b>	T2019/3701
		<b>File Number:</b>	BM-2-2-2020

### Action sought

	Action sought	Deadline
Hon Grant Robertson (Minister of Finance)	<p><b>Discuss</b> this report with officials at Budget Matters on 3 December 2019</p> <p><b>Refer</b> this report to Hon Dr David Clark and Hon David Parker ahead of the discussion.</p>	3 December 2019

### Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Ashleigh Brown	Analyst, Budget Management	[39]	N/A (mob) ✓
Alex Harrington	Manager, Budget Management		[23]

### Minister's Office actions (if required)

**Return** the signed report to Treasury.

Note any feedback on the quality of the report

**Enclosure:** Annex of draft cost pressure packages

## Executive Summary

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Ministers submitted cost pressure initiatives for Budget 2020 on 1 November 2019. Overall, 194 initiatives were submitted, seeking operating funding of \$3.7 billion operating per annum and total capital funding of \$6.1 billion. These figures compare with a remaining Budget 2020 operating allowance of \$2.6 billion per annum after pre-commitments, and a remaining multi-year capital allowance of \$4.4 billion (noting that this will be topped up to \$8.4 billion in the *Budget Policy Statement*).

New spending initiatives are due on 29 November 2019. We will report to you in the week of 2 December on how much has been sought by Ministers for new initiatives.

Treasury vote teams have completed assessments of individual cost pressure initiatives. Overall, Treasury vote teams supported \$3.0 billion operating per annum, and \$4.3 billion of capital.

To remain within available Budget allowances, and to leave room for new spending initiatives, we have taken the Treasury vote team assessments and reduced them further. We have developed two cost pressure packages for you to consider: a 'high' package and a 'low' package. The 'high' package averages \$2.0 billion operating per annum, and the 'low' package averages \$1.7 billion per annum. At this stage, we have not developed 'low' or 'high' capital cost pressure packages for you to consider – we will give you advice on capital initiatives in the New Year.

These two cost pressure packages would be consistent with remaining within available Budget allowances and providing funding for new spending initiatives within the funding ranges you have signalled to the Coordinating Ministers for the five Budget 2020 priorities.

This report provides you with information about these two cost pressure packages, including their key features, and the trade-offs and risks associated with them.

We would like to discuss this report with you at Budget Matters on Tuesday 3 December. We would also like to seek your views on the level of detail, and what decisions you would like to take regarding cost pressures at the Budget Ministers meeting on Monday 9 December.

## Recommended Action

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We recommend that you:

- a **note** that Ministers have submitted Budget 2020 cost pressure initiatives seeking \$3.7 billion per annum of operating and \$6.1 billion in total of capital;
- b **note** that we have developed 'high' and 'low' cost pressure packages for you to consider;
- c **discuss** this report with officials at Budget Matters on 3 December 2019;

*Agree/disagree.*

- d **refer** this report to Associate Ministers of Finance Hon Dr David Clark and Hon David Parker ahead of the discussion.

*Refer/not referred.*

Alex Harrington  
**Manager, Budget Management**

Hon Grant Robertson  
**Minister of Finance**

# Treasury Report: Budget 2020 Draft Cost Pressure Packages

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## Purpose of Report

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1. This report provides you with advice on draft 'high' (\$2 billion operating per annum) and 'low' (\$1.7 billion operating per annum) cost pressure packages for your consideration.

## Background

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2. Budget 2020 builds on the changes introduced in the first Wellbeing Budget to embed a more collaborative Budget process anchored around the Government's wellbeing and policy commitments.
3. As part of the Budget Cabinet Strategy paper, Cabinet agreed that cost pressures would be managed through a separate process from that run for new spending initiatives. This was to provide a clearer and earlier sense of cost pressures sought in Budget 2020.
4. To be eligible for Budget 2020 funding a cost pressure initiative must demonstrate:
  - a clear understanding of the most significant cost drivers across their agency that are creating the pressure;
  - that a high level of risk is attached to not funding these pressures, such as service failure, significant disruption to services, or not meeting legislative requirements;
  - where funding has already been provided in past Budgets to manage these, how has this been used and why is further funding required; and
  - what efforts have been made or are being made to manage the pressure within baselines, including reprioritising lower-value funding and/or reviewing current policy settings.

## Cost Pressure Submissions

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5. A total of 194 cost pressure initiatives have been submitted for Budget 2020, seeking \$3.7 billion operating per annum and \$6.1 billion total capital. These figures compare to a remaining Budget 2020 operating allowance of \$2.6 billion per annum<sup>1</sup>, and a remaining multi-year capital allowance of \$4.4 billion (noting that this will be topped up to \$8.4 billion in the *Budget Policy Statement*).
6. These figures do not include amounts sought for new spending initiatives. These are due on 29 November.

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<sup>1</sup> This reflects the remaining Budget 2020 operating balance after pre-commitments of \$350 million as at 28 November.

## Portfolios

7. As set out in Table 1, the majority of cost pressure funding is sought by health, education, and defence, though initiatives have been submitted across a wide range of portfolios.

Table 1 Top five portfolios by operating and capital

Operating per annum (\$m)	Total capital (\$m)
Health [33]	Health [33]
Education	Education
Defence	Courts 164
ACC 220	Social Development 102
Social Development 135	Conservation [33]
Other 1,031	Other 213
<b>Total 3,716</b>	<b>Total 6,114</b>

## Coalition, Confidence and Supply, and Speech from the Throne Initiatives

8. Table 2 lists initiatives that Ministers have indicated address outstanding political commitments.

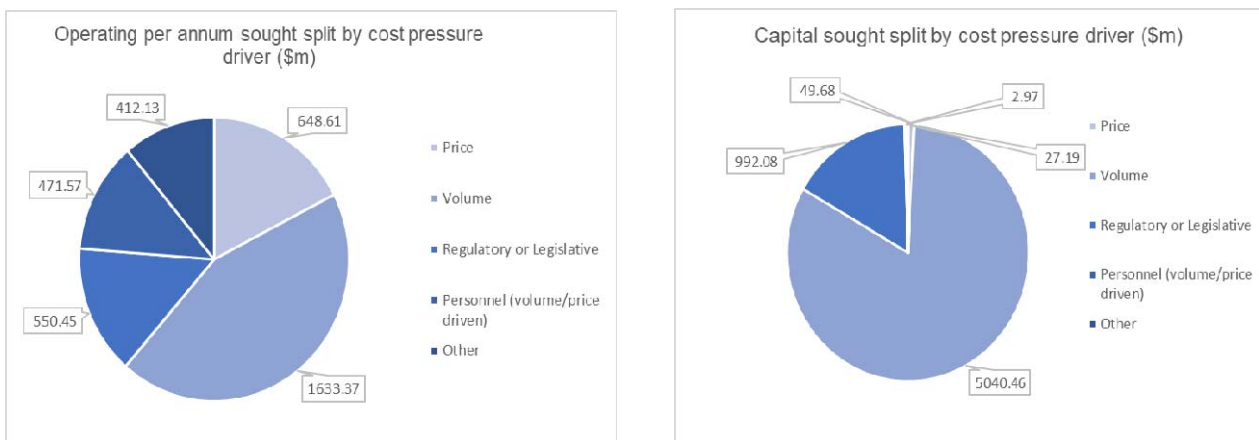
Table 2: Coalition, Confidence and Supply, and Speech from the Throne initiatives

Initiative title	Portfolio	Opex p.a. \$m	Capex \$m
<b>Coalition Agreement</b>			
[33]			
Sustaining core scientific research capability by increasing funding for Strategic Science Investment Fund Platforms	Research, Science and Innovation	[33]	
Managing the PGF beyond the life of the fund	Regional Economic Development	8	-
Sustaining critical forest science capability	Research, Science and Innovation	[33]	
Sustaining critical agricultural science capability	Research, Science and Innovation		
The Institute of Environmental Science and Research (ESR) Kenepuru Property Redevelopment	Research, Science and Innovation	-	-
[33]			
Overseas Investment Regime – Phase 2 Implementation	Land Information	2	1
Operation of the Criminal Cases Review Commission	Justice	[33]	
<b>Confidence and Supply</b>			
Effectively regulating residential tenancy and unit titles markets	Housing	6	2
Enabling the Ministry for Women to deliver on Government priorities for New Zealand women	Women	3	2
<b>Speech from the Throne</b>			
[9]			
Overseas Investment Regime Cost Pressures	Land Information	4	3
<b>Total</b>		<b>102</b>	<b>70</b>

## Cost Pressure Drivers

9. For Budget 2020 cost pressure initiatives have been limited to pressures driven by:
- volume;
  - price;
  - volume or price driven personnel-pressures; and
  - existing or impending legislation or regulation.
10. Figure 1 demonstrates the breakdown of submissions by primary drivers, as indicated by the submitting department. In many instances, a pressure will have multiple drivers.

Figure 1: Funding sought split by cost pressure driver for operating and capital



## Treasury Vote Team Assessments

11. Treasury vote teams have assessed individual cost pressure initiatives using the assessment criteria set out in the Budget 2020 guidance issued to agencies. Vote teams also considered whether the initiative was deliverable, robustly costed, and an appropriate response to addressing the cost pressure. These assessments have been moderated across teams to ensure consistency in approach.
12. On this basis, Treasury vote teams supported funding of \$3.0 billion operating average per annum, and \$4.3 billion of capital. Funding cost pressures at this level would not be consistent with the available Budget allowances and leaving funding available for new spending initiatives.

## Budget 2020 Draft Cost Pressure Package

### Overall approach

13. To remain within Budget allowances, we have reduced the Treasury vote team assessments and developed 'high' (\$2 billion) and 'low' (\$1.7 billion) cost pressure packages for you to consider.



14. In order to set appropriate funding parameters for the cost pressure packages, we have taken a top-down approach, looking at the funding remaining within allowances and building in potential funding for new spending initiatives. This is set out in Table 3 below. [33]

*Table 3: Determining the size of 'High' and 'Low' cost pressure allocations*

<b>Funding \$m</b>	<b>Low package</b>	<b>High package</b>
Budget 2020 operating allowance	3,000	3,000
Pre-commitments	[38]	[38]
Priority allocations	[33]	[33]
New spending – other	75	100
Between-Budget Contingency	40	50
<b>Remaining</b>	[33]	[33]

15. The 'low' package omits a number of initiatives the Treasury considers high risk and as such, we have developed a 'high' package that recommends funding these pressures. Annex 1 provides these 'high' and 'low' cost pressure packages for your consideration.
16. [33]

***'Low' package - \$1.7 billion average per annum operating***

17. This package is limited to non-discretionary cost pressures where not providing funding would result in, or risk, critical service failure or breach of legislative requirements. We have focused on areas of expenditure we consider critical to delivering core government services.
18. The five largest initiatives in this package are:
- District Health Boards – Additional Support (*\$648 million per annum*)
  - Supporting Disabled New Zealanders To Live Good Lives (*\$208 million per annum*)
  - Enabling the continuation of the Mycoplasma bovis eradication programme – Place holder (*\$102 million per annum*)

[33]

19. Some initiatives excluded from the 'low' package may also be considered non-discretionary, and not funding these may still result in service failure, issues with workforce retention and recruitment, or not meeting legislative requirements.

20. The 'low' package does not address some pressures that may be detrimental to wider system sustainability and wellbeing outcomes.
21. If unfunded, some of these pressures may defer funding requests to future Budgets or result in an increase of requests for out-of-cycle funding. This may constrain future decision-making and reduce the impact of new spending initiatives funded through Budget 2020 due to ongoing capacity and capability pressures.

***'High' package - \$2 billion average operating per annum***

22. The high package recommends funding pressures to maintain service delivery at current levels of provision, address price pressures, avoid baseline 'funding cliffs' and reduce risk of redundancy.
23. This is a level of funding that we consider consistent with supporting system sustainability and wellbeing outcomes. The 'high' package recommends funding:
  - current levels of service provision for government services omitted from the low package and reducing wait times for services;
  - wage pressures, where if unfunded, may result in workforce loss and provider withdrawal;
  - capability investments where these pose risk to efficacy and quality of service delivery; and
  - components of initiatives scaled for the low package where genuine pressures exist but Ministers have discretion about the level of funding provided.
24. The five largest operating initiatives in this package are:
  - District Health Boards – Additional Support (*\$710 million per annum*)
  - Supporting Disabled New Zealanders To Live Good Lives (*\$208 million per annum*)
  - Enabling the continuation of the Mycoplasma bovis eradication programme – Place holder (*\$102 million per annum*)

[33]

25. This package does not recommend funding some initiatives where unfunded pressures may result in decreased scope and quality of service provision, capability pressures, and still poses a risk of increased pressure on future allowances.

## Capital Package

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26. Funding of \$6.1 billion total capital has been sought for cost pressures. Treasury vote teams have supported \$4.3 billion capital of these initiatives.

27. At this stage we have not developed 'low' or 'high' capital cost pressure packages for you to consider. As part of the Budget 2020 process, the Treasury will be taking a system wide view across all capital investments and will provide advice on relative attractiveness and achievability of these investments. We will provide further advice for you around capital initiatives in the New Year.

**Cost pressure initiatives with digital, data and ICT components**

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28. As part of Budget 2020, you requested that agencies seeking funding for initiatives with significant digital, data or ICT components engage with the Government Chief Digital Officer (GCDO) and Government Chief Data Steward (GCDS) in support of a more consistent approach to investment in these areas. Several agencies have engaged with the GCDO and GCDS regarding cost pressure initiatives. The Treasury will provide you separate advice on this.

29. Overall, 29 cost pressure initiatives have signalled a data, digital and ICT component, totalling \$493 million in operating and \$105 million in capital. We consider that the data, digital and ICT components of this amount are likely to be small amounts, so the total amount sought directly relating to data, digital and ICT is likely to be very low in relation to the wider cost pressure package.

**Further Background on Key Portfolios**

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**Health**

*Table 4: Health cost pressures*

<b>Health Pressures (\$m)</b>	<b>Opex p.a.</b>	<b>Capex total</b>
Submitted	1,480	[33]
Vote team assessment	1,284	
'High' package	1,064	
'Low' package	938	

30. The Minister of Health has submitted cost pressures of \$1.5 billion operating per annum (including \$648 million for DHB cost pressures) and [33] in capital.

31. A large number of these bids are similar to submissions in previous Budgets, reflecting required annual adjustments to funding as a result of demographic and wage pressures. However, several additional cost pressures have also been submitted to meet pressures related to public and population health measures and to support deficits faced by other Crown entities [33]

32. The majority of the pressures supported by the vote team (which include \$880 million per annum for DHBs) require funding if services are to continue at current levels, in the context of a growing population and a high wage pressure environment. The efficiencies available through tight budget caps have been largely exhausted, and non-government providers now need funding certainty to transition to higher-value models of care in response to service and system reviews.

**Education**

Table 5: Education cost pressures

Education Pressures \$m	Opex p.a.	Capex total
Submitted	[33]	
Vote team assessment	320	115
'High' package	159	115
'Low' package	122	-

33. The Minister of Education has submitted cost pressures of [33] operating per annum and [33] in capital. [33]

- 35. The schools' cost adjustment, if funded, will provide direct funding to schools' Operational Grants. We are aware of both cost pressure and new spending initiatives that also seek funding which will increase schools' Operational Grants.
- 36. While it is likely that parts of each sector are facing genuine pressures related to the rising costs of service delivery, we have not included any of the cost adjustments in either of the draft packages.
- 37. We recommend that Ministers consider an affordable rate adjustment once decisions on other Budget bids have been taken. This will ensure Ministers have oversight of the relative priority of the infinitely scalable adjustments, and greater clarity on the quantum of funding provided to cost adjustments and subsidies within the education sector.

<sup>2</sup> This includes around [33] operating per annum for funding for heat, light and water. T2019/3701: Treasury Report: Budget 2020 Cost Pressure Draft Packages for Discussion

## Defence

Table 7: Defence cost pressures

Defence Pressures \$m	Opex p.a.	Capex total
Submitted	[33]	-
Vote team assessment		-

38. The Treasury has excluded New Zealand Defence Force (NZDF) and Ministry of Defence (MoD) cost pressures from the draft Budget 2020 packages, as funding options will be provided by the Defence Baseline Review. Based on early work, the Baseline Review's funding scenarios may range from approximately [33] million per annum. There will be a range of choices between these scenarios depending on your priorities.
39. The high funding scenario would allow MoD and NZDF to implement the Defence Capability Plan 2019 with minimal risk to output delivery, as well as increase the use of its current capabilities and prepare for the introduction of new capabilities.

[33]

41. There are also options around how the funding scenarios will be funded. Funding may be provided at each budget according to an indicative medium-term track, or a multi-year approach may be taken where the funding is provided either entirely from Budget 2020 allowances, or partly from Budget 2020 allowances and partly from a pre-commitment against future allowances.
42. The Defence Baseline Review will provide its final funding options and recommendations in February 2020.

## Social Development

Table 8: Social Development cost pressures

Social Development Pressures \$m	Opex p.a.	Capex total
Submitted	135	100
Vote team assessment	99	60
'High' package	94	60
'Low' package	85	60

43. The Ministry of Social Development's (MSD) Baseline Review (the Review), commissioned in July 2018, was conducted jointly by MSD and the Treasury. The purpose of the Review was to understand the efficiency and effectiveness of MSD's baseline expenditure. The Review found that the agency had absorbed an approximate 25% cost increase to core services between 2007/08 and 2017/18, and that increases in demand, volume and complexity were placing pressures on MSD's capacity to deliver services.
44. As a response to these findings, a stabilisation package was mostly funded through Budget 2019 (\$121 million per annum over four years). The package balanced addressing MSD's immediate operating model pressures, while also funding some new initiatives focused on delivering client outcomes.
45. Three Budget 2020 bids are for cost pressures relating to MSD's underlying infrastructure. MSD's technology and property fit-out initiatives were signalled as part of the Review but funding was not sought in Budget 2019. Based on the analysis in the Review, we agree that MSD has limited scope to fund these pressures from within baselines without significant reprioritisation of existing activities. The remaining cost pressure bids submitted relate to community services and are not departmental.

## Next Steps

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46. We would like to discuss this report with you at Budget Matters on Tuesday 3 December, including seeking your views on what detail and decisions you would like to take about cost pressures to the Budget Ministers meeting on Monday 9 December.
47. You have the following scene setting meetings scheduled with Vote teams which includes more detailed discussion on Vote team assessments:
  - Justice – Monday 9 December
  - Social Development – Monday 9 December
  - Health – Tuesday 17 December
  - Education – Wednesday 18 December
48. Vote teams will be providing you separate advice ahead of these meetings.