

# The Treasury

## Budget 2021 Information Release

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Minister of Finance

Chair

Cabinet

## **Budget 2021: Strategy and Design**

### **Proposal**

1. This paper seeks agreement to the Budget 2021 strategy and process. The proposed strategy supports the Government's priorities and wellbeing objectives. It also has a strong focus on implementation and delivery, progressing priority manifesto commitments, and continuing to invest in critical public services as we recover from COVID-19.

### **Executive Summary**

2. The Government's priorities for the next three years are:
  - 2.1. continuing to keep New Zealand safe from COVID-19,
  - 2.2. accelerating the recovery and rebuild from the impacts of COVID-19, and
  - 2.3. laying the foundations for the future, including addressing key issues such as climate change response, housing and child poverty.
3. As a consequence of the wider economic outlook and fiscal constraints, it is more important than ever to ensure a balanced approach. This requires investing in our priorities while ensuring that all Government spending decisions are made with particular consideration for the sustainability of the Crown's long-term fiscal position. The approach to Budget 2021 and future Budgets will require greater discipline, while paving the way for further reforms to the annual budgeting process.
4. I recommend that, as set out in Labour's election fiscal strategy, the operating allowance for Budget 2021 is set at \$2.625 billion per year, and that the Multi-Year Capital Allowance for Budgets 2021 to 2024 is set at \$7.8 billion.
5. There are a number of priority manifesto commitments and critical cost pressures that need to be managed within these allowances, therefore it is of the utmost importance that spending is prioritised effectively and focus is placed on achieving value for money when making spending decisions.
6. To maximise progress on the change we want to deliver, we need to shift focus and resources towards targeting the drivers of wellbeing that matter the most to New Zealanders, and set a high bar for the value for money for all expenditure. Therefore before committing any additional spending, we need to ensure that we are delivering existing commitments.

7. Budget 2021 is an important tool to help achieve the Government's priorities set out in paragraph 2. It also provides an opportunity to re-emphasise our commitment to our long-term wellbeing objectives. By ensuring the fiscal position does not become unsustainable we can continue to progress our wellbeing objectives, our response to COVID-19 and deliver on the Speech from the Throne. Therefore I am seeking approval to the following priorities for Budget 2021:
  - 7.1. continuing the COVID-19 response,
  - 7.2. delivering priority and time-sensitive manifesto commitments,
  - 7.3. supporting core public services through managing critical cost pressures and manifesto commitments, and
  - 7.4. continuing to deliver on existing investments.
8. To support these priorities, I propose an invitation-only Budget process that limits new spending to only critical cost pressures and time-sensitive priority manifesto commitments. I will be writing to individual Ministers shortly outlining my expectations for Budget 2021 and inviting them to write a letter detailing the critical cost pressures facing their portfolios over the next three budgets.
9. For any invited cost pressure funding, there is an increased expectation for quality information on the underlying cost drivers, assumptions, and impacts of these pressures to be provided. I expect portfolio Ministers to be engaging with their agencies on options to manage pressures. I also propose that any manifesto commitments which progress through the Budget 2021 process are subject to the same information requirements as cost pressure initiatives.

### **Progressing the Government's Priorities**

10. The Prime Minister has indicated that the Government's priorities for the next three years are:
  - 10.1. continuing to keep New Zealand safe from COVID-19,
  - 10.2. accelerating the recovery and rebuild from the impacts of COVID-19, and
  - 10.3. laying the foundations for the future, including addressing key issues such as climate change response, housing, and child poverty.
11. The annual Budget is one lever to support us in delivering these priorities, but it is not the only one. The wider economic and fiscal context will limit what we can feasibly do through the new spending allocated in the annual Budget.
12. The last of these three priorities shows that our long-term objectives around improving wellbeing remain important and require increased urgency in the light of the impact of COVID-19. In addition, amendments that we have made to the Public Finance Act 1989 now require the Government to set out the broad strategic priorities, policy goals and – for the first time – wellbeing objectives in the Budget Policy Statement, and to report against these in the Fiscal Strategy Report.

13. I propose that the existing five wellbeing objectives<sup>1</sup> from the last two Wellbeing Budgets form the basis of the wellbeing objectives, but that they be amended in light of the impact of COVID-19. I will incorporate these amended wellbeing objectives in the Budget Policy Statement which I propose to release in February 2021.
14. We will continue to build on the progress we made in the last term on applying a wellbeing approach in the Budget process, such as in setting priorities and analysing initiatives through to greater use of collaborative, whole-of-government approaches to addressing complex problems.

## **Economic Outlook and the Fiscal Context**

### *Economic Outlook*

15. The global and domestic economic outlooks remain uncertain. In recent months, the New Zealand economy has performed better than expected, with fiscal policy playing an important role in limiting the economic impacts of the pandemic. An extended period operating at Level 1 will likely see this continue, particularly in the lead up to Christmas. However, the outlook remains dependent on the path of the virus globally, and weak when compared to a pre-COVID-19 environment.
16. In particular, there are downside risks to the global economic outlook as countries take measures to get second-waves under control. This means the medium-term outlook for the New Zealand economy remains uncertain. The nature of the shock means the impacts are felt very differently across society, with some groups and sectors of the economy experiencing particularly sharp declines in income.
17. Monetary policy has also played an important supportive role in bolstering economic outcomes, with the Reserve Bank's use of Large-Scale Asset Purchases. The Reserve Bank has indicated it will use further tools as necessary to support the economy and to achieve the goals of stable inflation and maximum sustainable employment, although it is likely fiscal policy will remain best placed to address the challenges from COVID-19.

### *Fiscal Context and Strategy*

18. The fiscal environment is constrained. In the pre-election forecasts, net debt is expected to peak at over 56 per cent of GDP and is not projected to fall until beyond the mid-2020s. COVID-19 has created an on-going fiscal deficit, with the operating balance (before gains and losses) forecast to be at 3.4 per cent of GDP in 2024. This means expenses exceed revenue by over \$12 billion a year.
19. New Zealand also continues to face challenges of an ageing population and rising healthcare costs common to many developed economies. This will put further pressure on the fiscal position and funding this through persistent deficits will result in debt rising at an unsustainable rate.

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<sup>1</sup>Note these are: Just Transition, Future of Work, Māori and Pacific Peoples, Child Wellbeing, and Physical and Mental Wellbeing.

20. We campaigned on a balanced fiscal approach to carefully manage the country's finances, while responding to COVID-19 and ensuring all New Zealanders have the essential services on which they rely.
21. There remains space for temporary short-run support in response to COVID-19 if needed. However, keeping debt under control will require stricter management of on-going spending so the fiscal position does not become unsustainable. This means setting firm Budget allowances and strictly adhering to them. It also means that temporary COVID-19 spending should be dealt with outside of these allowances to prevent permanent baseline increases.
22. I recommend that the operating allowance for Budgets 2021-2024 is set at \$2.625 billion per year, as set out in our manifesto. I further recommend that the Multi-Year Capital Allowance for Budgets 2021 to 2024 is set at \$7.8 billion.
23. The short-term intentions and long-run objectives set out at Budget 2020 were appropriately flexible and recognised the high level of uncertainty we were operating under. I believe there is value in updating these to formalise the fiscal strategy we campaigned on and to support stricter control of on-going spending. I will bring this to Cabinet before presentation of the Budget next year.

### **Strong Focus on Delivery, Existing Expenditure, and Non-Spending Initiatives**

24. As a Government, we need to focus on all the levers we have available and not just the new spending allocated in the annual Budget. This includes:
  - 24.1. ensuring expenditure within existing baselines is aligned to our priorities and delivering value for money,
  - 24.2. delivering the significant investments we have made over the past year, in particular ensuring that they are delivered on time and within budget, and
  - 24.3. progressing non-spending new initiatives, such as regulatory reforms, where they align to our priorities.
25. I expect Ministers to be working with their colleagues and agencies on these levers. I expect Ministers to clearly demonstrate that these other levers cannot be used to deliver the outcomes sought before considering any requests for additional funding.

### *Savings and Baseline Reprioritisation*

26. Although we will deliver on some manifesto commitments in Budget 2021, we will need to free up funding to reinvest in our key priorities in subsequent Budgets. This will require decisions to reprioritise existing spending and remove spending that does not align with priorities. The fiscal and economic context has changed, which means it is appropriate to review previous Budget allocations and commitments from the previous term of Government to ensure they align with the current Government priorities.
27. This will require ongoing scrutiny of overall spending, including in both departmental and non-departmental baselines. It is my strong expectation that Ministers work with their agencies to identify savings to help deliver the Government's agenda over the next three years, including for Budget 2021. It is also my expectation that Ministers demonstrate that they have considered whether some or all of an initiative could be funded from reprioritisation or current baselines before seeking new funding. This work will be requested as part of Budget discussions.

### *Non-Spending Initiatives*

28. During an extended period of constrained additional spending, quality regulatory settings will play a larger role in achieving the Government's objectives. Many of New Zealand's long-standing challenges need regulatory reform to shift the incentives in the system. Smart, targeted public investment can be deployed to complement regulatory reform.
29. As part of Budget 2021, I am asking that Ministers identify key regulatory options, and link spending to these to strengthen the case for investment.

### *Existing Expenditure and Investment*

30. Substantial amounts of funding have been allocated this year to support the COVID-19 response. Decisions were made under extremely tight timeframes and there was limited opportunity to undertake robust value for money analysis. The fiscal implications of this spending are significant, limiting fiscal space for new spending in Budget 2021 and beyond. In some areas there has also been limited progress in the delivery of the programmes agreed recently.
31. It is therefore appropriate to consider whether initiatives with ongoing fiscal implications (beyond the current financial year) represent best value for money and should continue to be funded ahead of other Budget priorities. I will engage shortly with relevant portfolio Ministers on this and reprioritisation options, but it is my expectation that all Ministers who are responsible for COVID-19 Response and Recovery Fund funding will assess both the ongoing need for funding and the ability to deliver those initiatives.
32. The Treasury has undertaken an initial review of initiatives funded through the 16 March Package and COVID-19 Response and Recovery Fund. Budget Ministers will be considering reprioritisation of this funding against other government spending priorities through the main Budget 2021 process.
33. I am also reviewing capital investment to manage risk and ensure value for money, including investments funded through the New Zealand Upgrade Programme. I will be engaging with relevant portfolio Ministers about next steps shortly.

### **Expectations on Fiscal Management**

34. We have seen considerable pressure on allowances over the last few Budgets, as well as a high and growing number of initiatives being submitted. Spending outside of the Budget cycle and the use of tagged contingencies have also increased substantially: there is currently over \$4 billion operating and \$7 billion total capital held in tagged contingencies. This is more than the amount of funding that is typically allocated in a Budget. Until it is drawn down and spent, this funding is not supporting our priorities, nor is it improving wellbeing outcomes for New Zealand.
35. These trends have impacted the ability to maintain focus on delivering improved wellbeing outcomes through high-value initiatives, decreased visibility of trade-offs between maintaining existing services and funding new policy ideas, and have impacted on the ability of agencies to implement and deliver new initiatives.

36. We must commit to managing spending decisions within allowances, considering trade-offs appropriately and transparently, and clearly demonstrating value for money throughout the entire decision-making process.
37. There will be an exceptionally high hurdle that any out-of-cycle funding request will need to meet. In addition to the Cabinet requirements outlined in Cabinet Office Circular (18) 2<sup>2</sup>, my ongoing fiscal management expectations are that we:
  - 37.1. Ensure that existing and future investment is high-value and supported by detailed policy development and clear cost benefit analysis, while also actively identifying opportunities for reprioritisation. I will not support recommendations such as “agree in principle”; when the necessary policy work has not been undertaken,
  - 37.2. Explicitly identify the trade-offs when determining spending decisions, ensuring that successful initiatives represent the best possible value for money and clearly contribute to the wellbeing objectives and Government’s priorities,
  - 37.3. Continue to closely monitor the actual spend of existing appropriated operating funding and the implementation of capital initiatives, in particular the spend made through the COVID-19 Response and Recovery Fund and New Zealand Upgrade Programme initiatives,
  - 37.4. Closely monitor and limit the use of tagged contingencies to ensure that funding is allocated only when there is detailed policy development and that an initiative is implementation ready. Therefore the use of contingencies should be used only in instances where it would not be reasonable to appropriate funds, for example due to ongoing employment or commercial negotiations or litigation.
38. To support this, I intend to delegate to the Associate Minister of Finance (Hon Dr Megan Woods) the task of driving work on expenditure control.
39. Changes to the public finance system will also be required over the medium term. Early in the new year I intend to bring a public discussion document to Cabinet with proposals to reform the public finance system.

## **Budget 2021**

40. As mentioned above, I propose to set the Budget 2021 operating allowance at \$2.625 billion per year, and set aside \$7.8 billion total capital (for the next four Budgets). There are a number of Government manifesto commitments and cost pressures that need to be managed within these allowances.
41. Additionally, I am aware there will be significant operating and capital cost pressures for Budget 2021, driven by volume, wage and price increases across key sectors.
42. I expect portfolio Ministers to be engaging with their agencies on the key cost drivers, options to manage pressures, and associated risks and implications. This should also include exploring options to reprioritise lower value expenditure that is not clearly aligned to Government priorities.

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<sup>2</sup> [Cabinet Office Circular \(18\)2](#).

## **Priorities for Budget 2021**

43. Budget 2021 provides an opportunity to build on the Government's strong response to COVID-19 in order to safeguard against the threats it poses to wellbeing, while continuing to make progress on New Zealand's long-standing challenges. We have heavily invested in these areas already and now is the time to ensure that these initiatives are delivering on our expectations.
44. Like the wellbeing objectives, the Budget priorities will require ongoing attention and investment of resources. To give effect to the Government's priorities and achieve our wellbeing objectives, I propose the following priorities for Budget 2021:
  - 44.1. continuing the COVID-19 response,
  - 44.2. delivering priority and time-sensitive manifesto commitments,
  - 44.3. supporting core public services through managing critical cost pressures and manifesto commitments, and
  - 44.4. continuing to deliver on our existing investments.
45. These priorities are the focus for both spending and non-spending initiatives and Our Recovery Plan sets out some of the detail for how we will address these over the next three years.

## **Budget 2021 Process**

46. Budget 2021 will be a more constrained process given the timing of the 2020 General Election. To ensure we can deliver on our objectives there will be a greater level of top-down direction. The expectations for Budget 2021 are that:
  - 46.1. Ministers will submit initiatives only on the invitation of the Minister of Finance,
  - 46.2. these initiatives will be limited to the highest priority manifesto commitments and critical cost pressures,
  - 46.3. proposals not progressing a manifesto commitment or addressing critical cost pressures will be out of scope for Budget 2021, and
  - 46.4. beyond this process, Ministers will work with agencies to identify any reprioritisation opportunities or non-spending initiatives that will ease pressure on the allowances while still helping the Government to achieve its wellbeing objectives.

47. I am committed to ensuring that all proposals in Budget 2021 are managed within the operating and capital allowances. This will involve decisions around prioritisation, phasing of commitments, and reprioritisation of baseline spending.

		Operating Allowance \$2.625 billion Multi-Year Capital Allowance \$7.8 billion (2021-2024)	
CATEGORY		Cost Pressures	Manifesto
	SCOPE	Strict invitation-only, centrally managed process for critical cost pressures.	Strict invitation-only process limited to highest priority manifesto commitments.
	REQUIREMENTS	Cost pressure initiatives will be subject to rigorous information requirements around cost drivers, assumptions, expected impacts, and business cases where required.	Proposals will be subject to greater quantification and valuation of wellbeing impact requirements, and business cases where required.

Figure 1 Scope for Budget 2021

*Bilateral Meetings and Process for Inviting Initiatives*

48. Shortly I will write to individual Ministers and their Chief Executives outlining my expectations around Budget 2021 and fiscal management. This letter will also invite Ministers to write to me identifying manifesto commitments and any critical cost pressures in their portfolios over the next three budgets. While not all commitments and pressures can be addressed in Budget 2021, I am interested in having early discussions about options to manage and phase pressures. The letters should also identify any reprioritisation opportunities or non-spending initiatives that will ease pressure on the allowances while still helping the Government to achieve its wellbeing objectives.
49. Following my receipt of these letters, I will hold a small number of bilateral meetings with the select Ministers. Some of these meetings may be with groups of Ministers in areas where policy collaboration supports our wellbeing approach. This will also help with sequencing of the implementation of our commitments.
50. I will then issue formal invitations to submit Budget initiatives based on these discussions and advice from my officials. Following invitation, Ministers and their agencies will have until 29 January 2021 to develop and submit their initiatives.

## *Manifesto Commitments*

51. New spending initiatives in Budget 2021 will be limited to priority and time-sensitive manifesto commitments proposed in Labour's election fiscal strategy, manifesto documents, and shortly the Speech from the Throne. This reflects that we have three Budgets to deliver on all these commitments.
52. I propose that all manifesto initiatives are subject to the same information requirements as cost pressure Budget initiatives, including cost benefit analysis and business cases (where relevant). This is to ensure that the initiatives we have committed to are cost effective, are implementation ready and will deliver the intended outcomes.

## *Cost Pressures*

53. Cost pressures cover existing services and outputs which are facing wage, price, or volume pressures and where an agency cannot continue to deliver the same level or quality of service within existing baselines.
  - 53.1. **Volume pressures:** these can arise from population growth, changes in population characteristics, or changes in the economic environment. They are client driven and includes pressures arising from reduction in third party revenue.
  - 53.2. **Personnel and wage pressures:** this includes pressures associated with bargaining and remuneration outcomes and/or due to progression. It does not include generic wage pressures.
  - 53.3. **Price pressures:** these not only include changes in cost of inputs (e.g. as a result of inflation), but also changes in capital-related operating expenditure resulting from increases in the value of capital assets.
54. Over the last three years we have made significant progress in addressing cost pressures in core public services. We remain committed to investing in critical public services, particularly in health and education, but given the fiscal environment not all cost pressures will be managed through Budget 2021.
55. I am interested in understanding pressures Ministers are expecting to face in their portfolios over the coming years and will be inviting Ministers to write to me outlining these. As with our manifesto commitments, we will need to consider phasing and timing options for funding cost pressures over the next three budgets.
56. For invited cost pressure submissions, I expect Ministers and agencies to demonstrate:
  - 56.1. a clear understanding of the most significant cost drivers across their portfolio that are creating these pressures,
  - 56.2. 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,
  - 56.3. where funding has already been provided in past funding rounds to manage these, how this has been used and why further funding is required, and
  - 56.4. what efforts have been made, or are being made, to manage these pressures within baselines, including reprioritising lower-value funding and/or reviewing current policy settings.

57. In particular, there are immediate actions relating to personnel spending we should consider to support proactive expectation-setting and effective prioritisation of constrained capability. A significant portion of the cost of public services relates to paying employees (approximately 20 per cent of government spending) or publicly funded workforces, with approximately half of these costs arising in the health and education sectors.
58. In the short term, New Zealand's labour markets are expected to be constrained. The Public Service Commissioner has issued pay restraint guidance until June 2021 for all public service departments and departmental agencies, which places public sector pay growth closer in line with wider New Zealand.
59. I understand Te Kawa Mataaho (The Public Service Commission) is preparing advice in consultation with the Treasury on updating the Government Expectations for State Sector Employment Relations and any further pay restraint guidance in early 2021. I will be looking to reinforce expectations around management of personnel spending in the Budget guidance. We will also look to reinforce this through discussions with the New Zealand Council of Trade Unions.
60. Ministers play an important role in setting and communicating prudent expectations. I therefore invite the Ministerial Oversight Group for State Sector Employment Relations (MOGSSER) to provide oversight of Budget 2021 personnel initiatives to support effective prioritisation and management of personnel spending.

#### *New Capital Investment and Cost Pressures – Constraints and Expectations*

61. When considering new capital investment and cost pressures, we must acknowledge the significant increase in capital investment we have made in the past two years. Despite this increase, we know that capital investment is not constrained in the same way as operating. Capital investment has grown faster than our ability to deliver.
62. The problem is not the availability of funding, but the capacity and capability of our agencies to deliver these investments. To be clear, we have made considerable commitments to capital expenditure that we must now focus on delivering. We must ensure that the limited capability we have is directed towards investments that provide the greatest value to New Zealanders, and avoid taking on more than the system can reasonably deliver.
63. In light of these constraints and the increase in investment, I am committed to ensuring that any high-value capital investments considered in Budget 2021 and beyond are well-developed and ready for implementation. This means strengthening my expectations of good planning to ensure that our capital investments have the best possible chance of succeeding.
64. For invited capital spending, I expect Ministers and agencies to demonstrate that any proposed capital investments are well-planned, have appropriately assessed risk, have engaged with existing system experts and have appropriate capability and capacity dedicated to their delivery.
65. However, we must focus on the delivery of current and critical capital investments in the near-term even as we set ourselves up well for the future.
66. Budget 2021 provides an opportunity to strengthen delivery planning now. I propose that, for Ministers that are not invited to submit capital initiatives in Budget 2021, we focus instead on planning initiatives for out-years. We must strike a balance between looking forward well while maintaining some agility in our decision-making to make the most of opportunities as they arise.

67. The Multi-Year Capital Allowance is currently \$7.8 billion and we need to ensure a significant portion of the Multi-Year Capital Allowance is sufficient to support capital investment over the next four Budgets. This supports a longer-term view of capital investments, increases confidence in the pipeline and encourages more robust planning, better managed risk, and more effective delivery.

#### *Value for Money and Cost Benefit Analysis Requirements*

68. I expect wellbeing analysis for Budget 2021 initiatives to be strengthened by rigorous value for money and cost benefit analysis.
69. In assessing value for money, I expect agencies to articulate how a proposal:
- 69.1. identifies wellbeing impacts in the Living Standards Framework (and other relevant frameworks),
  - 69.2. quantifies the wellbeing impacts using clear assumptions and evidence base, and
  - 69.3. values key impacts on a comparable basis.
70. All wellbeing impacts, whether quantified or monetised or not, will be considered in the value for money assessment. Distributional effects across the wellbeing impacts will also be considered.
71. This will require agencies to provide cost-benefit analysis for a proposal, including a high quality intervention logic and distributional analysis. The Treasury's CBAX tool provides confidence and consistency when valuing wellbeing impacts. Evaluation and implementation plans should reflect the quality of evidence and provide confidence in the delivery. In addition to informing decisions, better analysis will enable reporting against the wellbeing objectives in the Fiscal Strategy Report, as required by the Public Finance (Wellbeing) Amendment Act 2020.
72. Budget 2021 guidance will also include an update to help central government agencies more consistently include an economic value for greenhouse gas emissions, or avoided emissions.

#### *Further Guidance*

73. Further guidance will be provided to agencies in early December providing:
- 73.1. more detail on the requirements for cost pressures and manifesto initiatives,
  - 73.2. Budget initiative templates, and
  - 73.3. information on the assessment and decision-making process, including Ministerial engagement to support the development of the Budget package once initiatives are submitted.

## Key Timeframes Budget 2021

Item	Date
<b>Letter to all Ministers</b> outlining the approach to Budget 2021	Late November
<b>Budget 2021 Guidance for Agencies released</b> , including Budget initiative templates	Early December
<b>Select bilateral meetings</b> (if required) between portfolio Ministers and the Minister of Finance/Associate Minister of Finance to set out expectations and discuss cost pressures	7 – 20 December 2020
<b>Half Year Economic and Fiscal Update (HYEFU)</b> released	16 December
<b>Invitations sent</b> to select Ministers to submit initiatives	Before Christmas 2020
<b>Initiatives due from Ministers/agencies</b>	29 January 2021
<b>Budget Policy Statement (BPS)</b> released	February 2021
Budget Ministers 1 <sup>3</sup>	Mid-February 2021
Other Budget Ministers' meetings as required	March-April 2021
<b>Cabinet considers Budget package</b>	Early April 2021
<b>Budget Day</b>	Mid-May 2021

## COVID-19 Response and Recovery Fund Technical Matters

74. To date the Government has allocated \$36.7 billion from the COVID-19 Response and Recovery Fund for fiscal support measures to help cushion the impact on the domestic economy, protect jobs and support New Zealand's health response.
75. The Treasury's forecasts at the Pre-election Economic and Fiscal Update suggested that around \$5 billion of funding allocated from the COVID-19 Response and Recovery Fund may no longer need to be spent. This is largely owing to the uptake for a number of measures being less than expected, partly a result of our careful management during the COVID-19 health crisis. I am proposing that \$1 billion of the funding that has been allocated that is now not expected to be spent is added back to the COVID-19 Response and Recovery Fund, to be held in reserve should another outbreak of the virus occur.
76. Additional to this, I am also seeking approval to return any underspends from initiatives that received funding through the 6 July COVID-19 Response and Recovery Fund package to the Crown. Cabinet previously agreed that these underspends would be returned to the COVID-19 Response and Recovery Fund [CAB-20-MIN-0328 refers]. This is not consistent with the general management of underspends associated with other initiatives that have received COVID-19 Response and Recovery Fund funding.

<sup>3</sup> Budget Ministers will be the Prime Minister, the Minister of Finance and the Associate Minister of Finance (Hon Dr Megan Woods).

## **Financial Implications**

77. There are no direct financial implications resulting from this paper. The Half Year Economic and Fiscal Update will include the Budget allowances as agreed by Cabinet in this paper.

## **Legislative Implications**

78. There are no legislative implications associated with this paper.

## **Regulatory Impact Statement**

79. There are no regulatory implications associated with this paper.

## **Climate Implications of Policy Assessment**

80. Analysis required through Budget 2021 will support a more consistent understanding of the impacts on the climate, such as the economic value of greenhouse gas emissions and avoided emissions.

## **Population Implications**

81. The wellbeing analysis required through Budget 2021 will support a stronger focus on distributional impacts, including clearly identifying and taking into account any gender implications, implications for people with disabilities, and vulnerable populations.

## **Human Rights**

82. Budget 2021 will support Budget decisions based on a more holistic perspective of what matters for the wellbeing of all New Zealanders. This includes strengthening consideration of areas such as human rights alongside more traditional fiscal and economic considerations.

83. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

## **Consultation**

84. This paper was prepared by the Treasury.

## **Communications**

85. I will shortly write a letter to Ministerial colleagues and Chief Executives outlining the process for Budget 2021 and confirming expectations for fiscal management.

86. Guidance for agencies will then be issued by the Treasury in early December containing more details on the Budget 2021 process.

87. I note that the date of publication for the Half Year Economic and Fiscal Update (HYEFU) will be 16 December 2020. The Public Finance Act requires that this be delivered before the 31<sup>st</sup> of December.

88. I intend to release the Budget Policy Statement (BPS) in February 2021. It has been the practice to release the BPS at the same time as the HYEFU. However the Public Finance Act 1989 provides for the BPS to be delivered at any time up until the 31<sup>st</sup> of March each year. I believe it is prudent in a fast moving and uncertain time to wait until the new year to release the BPS.

89. I intend to announce the approach and timing of HYEPU and the BPS this week, subject to Cabinet approval of this paper.
90. At this stage we are working towards a Budget Day mid-May 2021 as is normal. The final Budget Day date will be announced at the time of the release of the BPS.

### **Proactive Release**

91. I propose delaying the release of this paper beyond the standard 30 business days as it will be released separately through the proactive release of Budget material following Budget 2021.

### **Recommendations**

The Minister of Finance recommends that Cabinet:

#### *Progressing the Government's Priorities*

1. **note** that the Government's priorities for the next three years are:
  - 1.1 continuing to keep New Zealand safe from COVID-19,
  - 1.2 accelerating the recovery and rebuild from the impacts of COVID-19, and
  - 1.3 laying the foundations for the future, including addressing key issues such as climate change response, housing, and child poverty;
2. **note** that the Public Finance Act now requires the Government to set wellbeing objectives in the Budget Policy Statement, and to report against these in the Fiscal Strategy Report;
3. **note** that I intend to use the existing Budget priorities from the last two Wellbeing Budgets as wellbeing objectives for the purpose of the Budget Policy Statement, updating them to reflect the impact of the COVID-19 pandemic;
4. **note** that the existing Budget priorities from the last two Wellbeing Budgets are:
  - 4.1 Just Transition;
  - 4.2 Future of Work;
  - 4.3 Māori and Pacific Peoples;
  - 4.4 Child Wellbeing; and
  - 4.5 Physical and Mental Wellbeing;

#### *Economic Outlook and Fiscal Context*

5. **note** that the economic outlook remains uncertain and the fiscal environment is constrained and that keeping debt under control will require stricter management of on-going spending;
6. **agree** to the following operating and capital allowances for Budget 2021 to Budget 2024:
  - 6.1 operating allowances set at \$2.625 billion per year;
  - 6.2 Multi-Year Capital Allowance set at \$7.8 billion total;

## *Strong Focus on Delivery, Existing Expenditure, and Non-Spending Initiatives*

7. **agree** that Ministers need to focus on all the levers available and not just the new spending allocated in the annual Budget, including:
  - 7.1 ensuring expenditure within existing baselines is aligned to our priorities and delivering value for money;
  - 7.2 delivering the significant investments we have made over the past year, in particular ensuring that they are delivered on time and within budget;
  - 7.3 progressing non-spending new initiatives, such as regulatory reforms, where they align to our priorities;
8. **invite** portfolio Ministers to consider these levers before any requests for new funding;
9. **agree** that Budget Ministers will review 16 March Package and COVID-19 Response and Recovery Fund initiatives against other spending priorities through the main Budget 2021 process, to ensure value for money and free up headroom for new spending;
10. **invite** the Minister of Finance to engage with relevant portfolio Ministers in relation to the continued need for and ability to deliver on:
  - 10.1 initiatives funded through the 16 March package and COVID-19 Response and Recovery Fund ahead of the Budget 2021 process; and
  - 10.2 recent capital investment decisions, to manage risk and ensure value for money;

## *Expectations on Fiscal Management*

11. **note** given the constrained fiscal environment, stricter management of on-going spending is required;
12. **agree** that all spending decisions must:
  - 12.1 be managed within allowances;
  - 12.2 consider trade-offs appropriately and transparently; and
  - 12.3 clearly demonstrate value for money;
13. **agree** that there will be an extremely high hurdle that any out-of-cycle funding requests will need to meet;
14. **note** that the Minister of Finance will not support agree in-principle recommendations for proposals that are not manifesto commitments;
15. **note** that the Minister of Finance will be significantly limiting the use of tagged contingencies;
16. **note** that the Minister of Finance will bring a public discussion document to Cabinet early next year with proposals to reform the public finance system;

## *Budget 2021*

17. **note** that there are a number of cost pressures and manifesto commitments that need to be managed within allowances over the next three Budgets;

18. **agree** the following priorities for Budget 2021:
  - 18.1 continuing the COVID-19 response;
  - 18.2 delivering priority and time-sensitive manifesto commitments;
  - 18.3 supporting core public services through managing critical cost pressures and manifesto commitments; and
  - 18.4 continuing to deliver on existing investments;
19. **note** that the Minister of Finance will shortly write to portfolio Ministers and Chief Executives outlining his expectations around Budget 2021 and fiscal management;
20. **agree** that for Budget 2021:
  - 20.1 Ministers will submit initiatives only on the invitation of the Minister of Finance;
  - 20.2 these initiatives will be limited to the highest priority manifesto commitments and critical cost pressures;
  - 20.3 proposals that do not progress a priority manifesto commitment or address critical cost pressures will be out of scope for Budget 2021; and
  - 20.4 beyond this process, Ministers will work with agencies to identify any reprioritisation opportunities or non-spending initiatives that will ease pressure on the allowances while still helping the Government to achieve its wellbeing objectives;
21. **note** that the Minister of Finance and the Associate Minister of Finance will hold a small number of bilateral meetings with relevant Ministers to discuss critical cost pressures and priority manifesto commitments in their portfolios;
22. **note** that following this the Minister of Finance will invite select Ministers and their agencies to submit in-scope initiatives by 29 January 2021;

#### *Cost Pressures*

23. **agree** that initiatives seeking funding to address cost pressures will be required to demonstrate:
  - 23.1 a clear understanding of the most significant cost drivers across their portfolio that are creating the pressure;
  - 23.2 a high level of risk is attached to not funding them;
  - 23.3 where funding has already been provided in past funding rounds to manage these, how this has been used, and why further funding is required; and
  - 23.4 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;
24. **note** that the Public Service Commission, in consultation with the Treasury, is preparing advice on updating the Government Expectations for State Sector Employment Relations and any further pay restraint guidance in early 2021;

25. **invite** the Ministerial Oversight Group for State Sector Employment Relations (MOGSSER) to provide oversight of Budget 2021 personnel initiatives to support effective prioritisation and management of personnel spending, and communicate restraint expectations;
26. **agree** that Budget Ministers will continue as a decision-making body in Budget 2021 to review progress, consider priorities and trade-offs across packages, and to recommend a final Budget package to Cabinet;
27. **agree** that Budget Ministers will consist of the following Ministers:
  - 27.1 the Prime Minister;
  - 27.2 the Minister of Finance; and
  - 27.3 the Associate Minister of Finance (Hon Dr Megan Woods);
28. **note** that the Treasury will be releasing further guidance to agencies on process and requirements for Budget 2021 in early December 2020;

#### *COVID-19 Response and Recovery Fund Technical Matters*

29. **note** that Treasury's forecasts at the Pre-election Economic and Fiscal Update suggested that around \$5 billion of funding allocated from the COVID-19 Response and Recovery Fund may no longer need to be spent;
30. **agree** that \$1 billion of the \$5 billion referred to in recommendation 29 above be returned to the COVID-19 Response and Recovery Fund;
31. **note** that Cabinet previously agreed that underspends from the 6 July COVID-19 Response and Recovery Fund package would be returned to the COVID-19 Response and Recovery Fund [CAB-20-MIN-0328 refers];
32. **agree** to recommend that Cabinet rescind the Cabinet decision referred to in recommendation 30 above; and instead
33. **agree** that any underspends associated with the 6 July COVID-19 Response and Recovery Fund package should be managed by returning funding to the Crown.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance