

The Treasury

Budget 2021 Information Release

August 2021

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- [36] 9(2)(h) - to maintain legal professional privilege
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- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
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Budget Ministers 1

Budget 2021: Strategic outlook and choices

16 February 2021

Purpose

The key objectives for this meeting are to:

1. Set the wider economic and fiscal context for Budget 2021
2. Provide an overview of the Budget 2021 initiatives that have been submitted
3. Discuss key strategic choices and trade-offs for Budget 2021

Economic Outlook

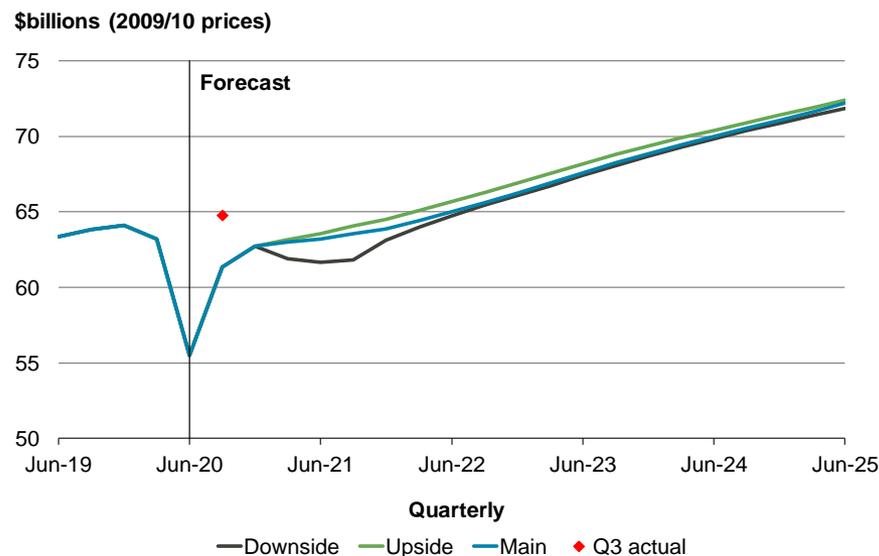
The New Zealand economy has proven to be more resilient than expected last year but considerable uncertainty remains.

Since the release of HYEFU in December we've seen:

- **Higher than anticipated GDP growth** of 14.0% in the September 2020 quarter.
- **Stronger than anticipated labour market data**, with the unemployment rate falling to 4.9% for the December quarter.
- Nominal GDP in the September 2020 quarter **nearly \$7 billion above forecast.**

Uncertainty remains around the evolution of COVID-19 and extent to which current economic strength will continue. Additionally, a number of measurement challenges mean **data may exhibit greater volatility** than normal.

Real production GDP HYEFU forecasts



Key milestones: Preliminary economic and tax forecasts are finalised on the **19 and 24 Feb** respectively. An update will be provided on these at Budget Ministers 2.

Fiscal Outlook

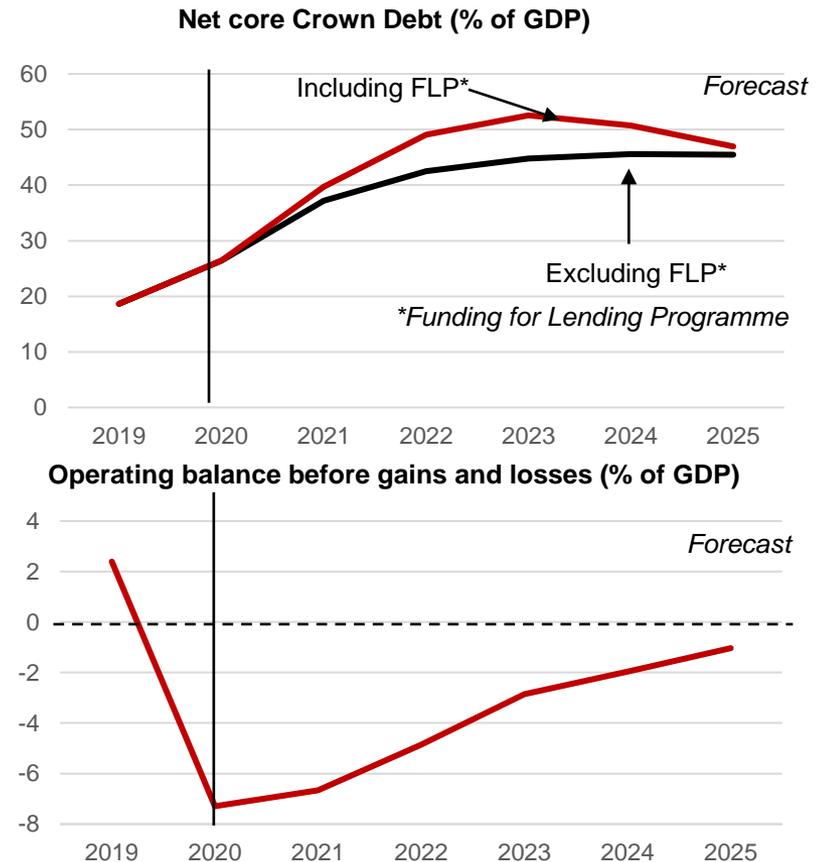
Although COVID-19 continues to have a significant impact on the fiscal position, the outlook looks set to improve relative to HYEFU.

The November 2020 Interim Financial Statements of the Government show a **stronger fiscal position than forecast at HYEFU**, with the OBEGAL deficit currently at \$4.3 billion, \$1.9 billion better than the deficit forecast at HYEFU.

Our fiscal strategy focuses on **reducing deficits in the short term, stabilising debt by the mid-2020s**, and then reducing debt further as conditions permit.

We are likely to meet these objectives, based on the current fiscal outlook and allowance levels.

Increases to allowances are possible, but should be traded off against the impacts on fiscal sustainability. The Government continues to face significant challenges relating to **long-term cost pressures**.



Key milestone: The Treasury will advise on the appropriate macroeconomic stance for fiscal policy on **25 Feb**. Preliminary fiscal forecasts are finalised on **23 March**. An update will be provided on these at Budget Ministers 2 and 3 respectively.

Overview of Budget 2021 strategy

The strategy for Budget 2021 is focused on ensuring the sustainability of the Crown's long-term fiscal position, while also progressing the Government's priorities and re-emphasising our commitment to our long-term wellbeing objectives.

The Government's **overarching policy goals** for the next three years are:

- continuing to keep New Zealand safe from COVID-19,
- accelerating the recovery and rebuild from the impacts of COVID-19, and
- laying the foundations for the future, including addressing key issues such as climate change response, housing affordability and child poverty.

Cabinet has agreed to the following **priorities for Budget 2021**:

- continuing the COVID-19 response,
- delivering priority and time-sensitive manifesto commitments,
- supporting core public services through managing critical cost pressures and manifesto commitments, and
- continuing to deliver on existing investments.

Overview of Budget 2021 strategy

Our **wellbeing objectives** at Budget 2021 are:

- **Just Transition** – Supporting the transition to a climate-resilient, sustainable and low-emissions economy while building back from COVID-19
- **Future of Work** – Enabling all New Zealanders and New Zealand businesses to benefit from new technologies and lift productivity and wages through innovation, and support into employment those most affected by COVID-19, including women and young people
- **Māori and Pacific** – Lifting Māori and Pacific incomes, skills and opportunities, and combatting the impacts of COVID-19
- **Child Wellbeing** – Reducing child poverty and improving child wellbeing
- **Physical and Mental Wellbeing** – Supporting improved health outcomes for all New Zealanders and keeping COVID-19 out of our communities.

In recognition of the constrained fiscal environment, in December 2020 I asked Ministers to write to me outlining their priorities over the next three Budgets, and invited them to submit only the most critical cost pressures and time-sensitive manifesto commitments for consideration in Budget 2021. I will discuss options for funding the uninvited initiatives through Budgets 2022 or 2023 at a later stage.

Ministers have now submitted initiatives for assessment by the Treasury. I will receive advice in early March on the Treasury's assessment of these initiatives, and options for a draft package.

COVID-19 context

To date, **\$39.8 billion** of the COVID-19 Response and Recovery Fund (CRRF) has been allocated, including recent measures to:

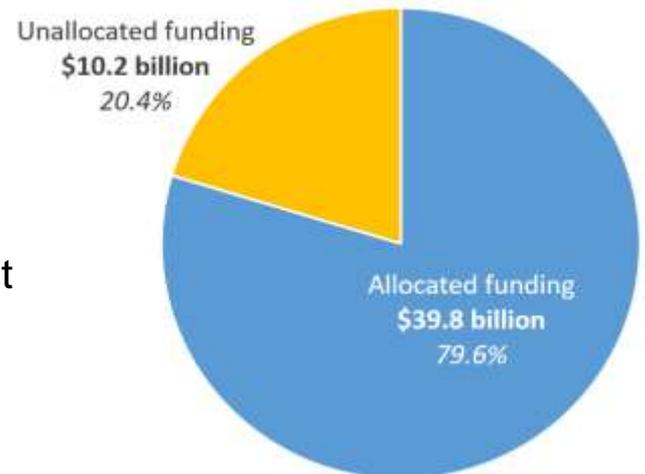
- support the health response to COVID-19 (\$1.3 billion)
- strengthen the MIQ operating model (\$1.7 billion)
- fund vaccine purchases (\$1.4 billion)

The remaining CRRF balance is **\$10.2 billion**. Cabinet has agreed settings for a business support package to be activated in the event of Alert Level escalations. For example, an event similar to the Auckland August outbreak would require total CRRF funding of around \$920 million.

While most COVID-19 response measures have been focused on providing short-term support, certain sectors face ongoing challenges. These include:

- the **tourism** sector, which has received \$400 million from the CRRF to date, and
- the **international education** sector, which has been allocated \$51.6 million from the CRRF to date.

Balance of the CRRF as at Feb 2021

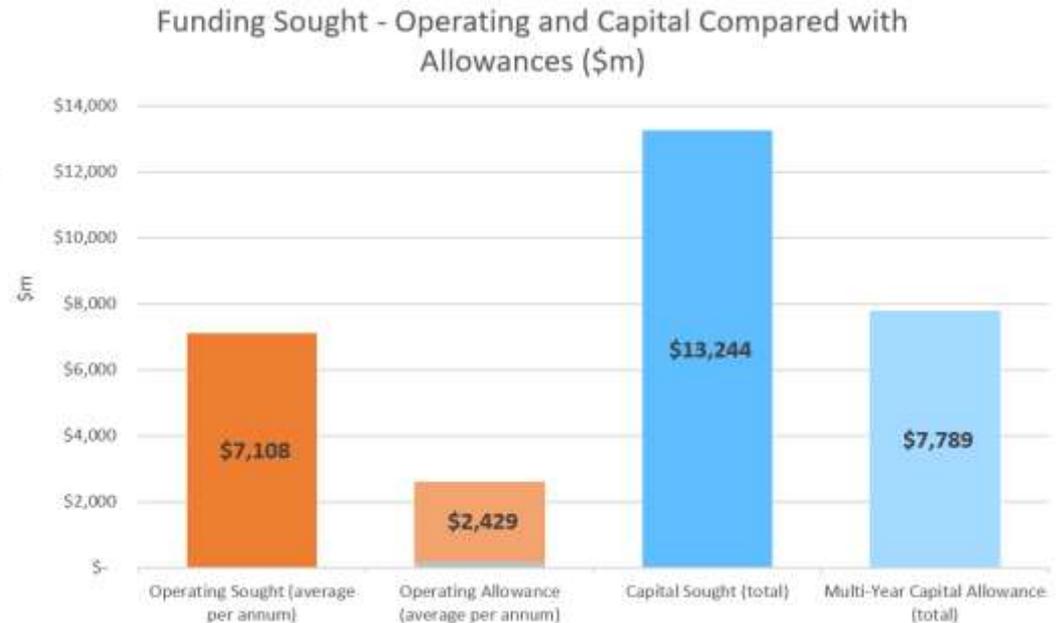
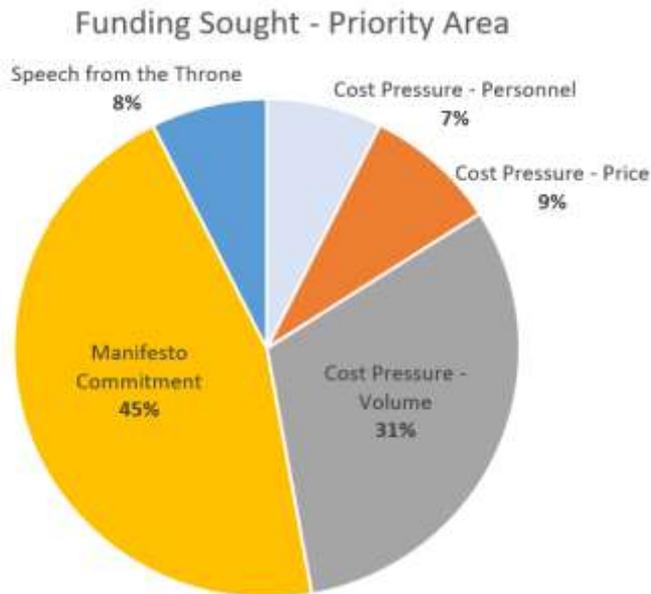


What has been submitted?

A total of **288 initiatives** have been submitted for Budget 2021.

\$ billions	Operating per annum	Total capital (MYCA) B21-B24
Budget 2021 allowances	2.4*	7.8
Total submitted across cost pressures and manifesto commitments	7.1	13.2

**After pre-commitments averaging \$196 million p.a.*



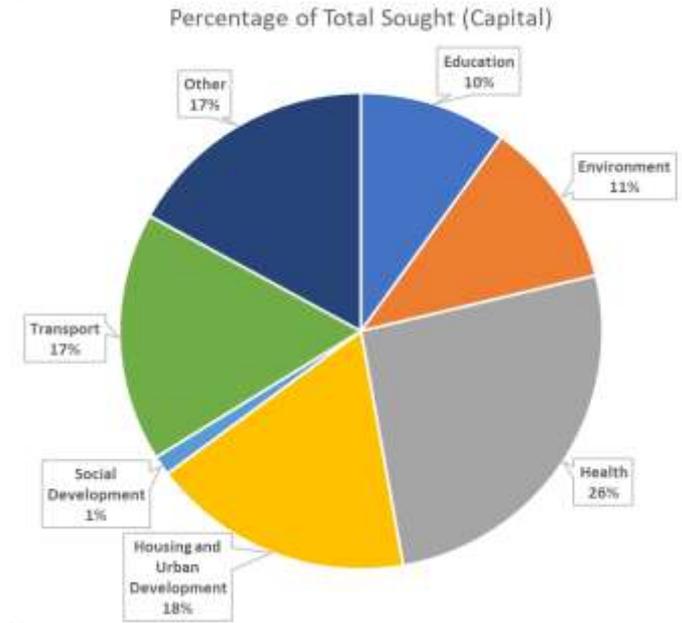
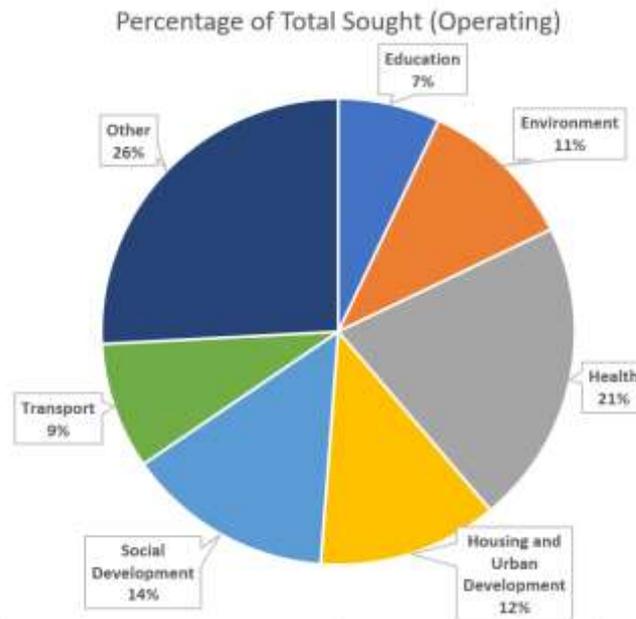
Note: unless stated otherwise, the figures used for operating funding are the total opex across the four-year forecast period.

Breakdown of submissions by key areas

A small number of large portfolios make up a significant portion of the total value of funding sought, across both operating and capital expenditure. These portfolios are closely aligned with the Government's priorities, so choices will need to be made about the appropriate balance of funding between these areas, and the relative priorities within each area.

With pressure on allowances, investing in these focus areas constrains how much funding is left for smaller portfolios.

Some initiatives in these areas have also been submitted as part of two proposed sector packages:



- A **climate package** of [33]
- A **Māori package** of [33]

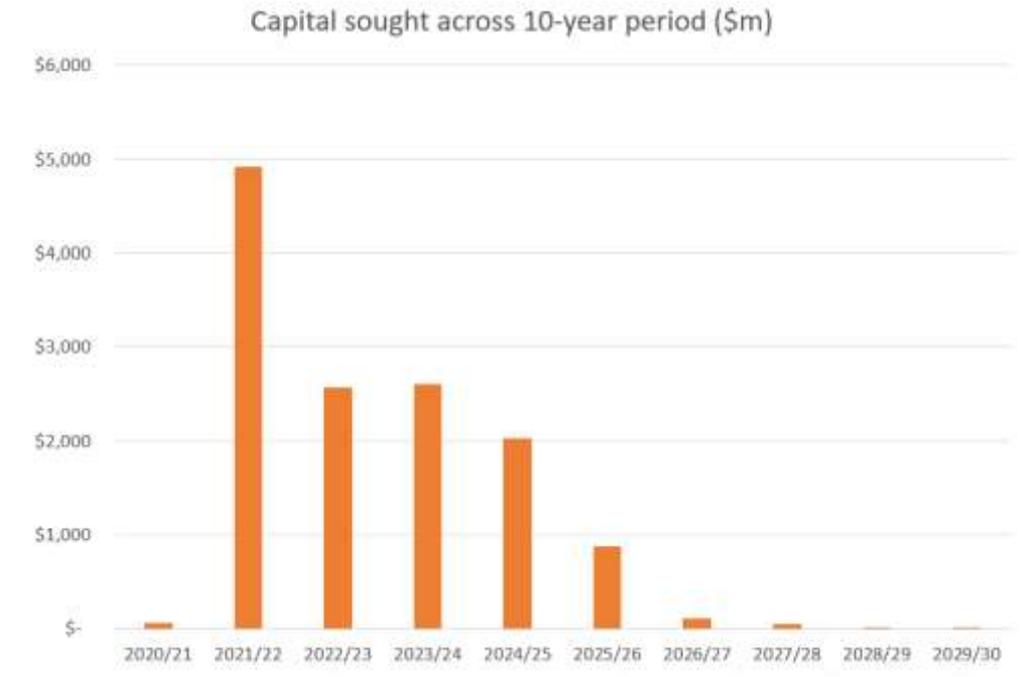
and
is for Māori Housing.

Capital initiatives

[33]

Unlike the operating allowance, which runs on an annual basis, the MYCA covers the next four Budgets. The MYCA was introduced at Budget 2019, moving away from a single-year allowance to allow for a longer-term investment approach for capital spending.

Although the MYCA can provide greater flexibility on capital allocation, it has been consistently front-loaded. This has reduced its ability to support longer-term planning, and led to delays in implementation with some projects that receive funding not being ready for investment. This will be a relevant consideration for Budget 2021, as the funding sought is heavily weighted toward the beginning of the forecast period.



Cost Pressures

182 initiatives have been submitted as cost pressures.

\$ billions	Operating per annum	Total capital (MYCA) B21-B24
Budget 2021 allowances	2.4*	7.8
Total submitted as cost pressure initiatives	3.4	6.1

**After pre-commitments averaging \$196 million p.a.*

The invitation process aimed to ensure that the cost pressures submitted are genuinely critical. All of these initiatives present a high level of risk if funding is not provided; we will need to consider which pressures are the highest priority.

Largest cost pressure initiatives submitted (by opex)

Vote	Initiative title	Total opex (\$m)
Health	Supporting District Health Boards Cost Pressure	[33]

[33]

[38]

Largest cost pressure initiatives submitted (by capex)

Vote	Initiative title	Total capex (\$m)
Health	District Health Boards' Capital Investment	[33]
Education	Funding the Next Phase of the National Education Growth Plan	
Environment	Recapitalising New Zealand Green Investment Finance Ltd	

Manifesto Commitments

106 initiatives have been submitted as manifesto commitments.

\$ billions	Operating per annum	Total capital (MYCA) B21-B24
Budget 2021 allowances	2.4*	7.8
Total submitted as manifesto commitment initiatives	3.7	7.1

*After pre-commitments averaging \$196 million p.a.

While we have more discretion over these initiatives than over cost pressure initiatives, they all represent measures which our government has committed to fund. The key choices will concern the relative priority and urgency of these commitments. I suggest a package focusing on several priority areas, such as welfare, housing, and climate.

Largest cost pressure initiatives submitted (by opex)

Vote	Initiative title	Total opex (\$m)
[33]		
Housing and Urban Development	Package to increase housing supply and improve affordability	2242
Social Development	Main Benefit Rate Increase and Complementary Changes	2165

Largest cost pressure initiatives submitted (by capex)

Vote	Initiative title	Total capex (\$m)
Housing and Urban Development	Investment to increase housing supply in large scale projects	[38]
Transport	Future of Rail – Rolling Stock and Mechanical Depots	[33]

Key strategic choices for discussion

Allowances for Budget 2021 are significantly oversubscribed and trade-offs will have to be made in developing a package.

Child poverty reduction, housing, and climate change are priority areas for our Government. But within these areas, there are a handful of large initiatives which each represent a substantial portion of the allowance if funded.

We will need to make choices about where we focus investment, particularly when significant amounts of funding are also being sought for critical cost pressures in areas such as Health and Education.

- **Key choice:** Do we want to focus new spending in one or two centrepiece initiatives within the priority areas of child poverty, climate change, and housing, or do we spend less across a broader range of portfolios?
- **Key choice:** Are there lower-priority manifesto commitments that can be deferred or sequenced to leave more room to address critical cost pressures in areas such as Health and Education?

Context for Budget 2021

Housing affordability

Housing has been identified as one of the Government's key wellbeing focus areas.

Despite the economic ramifications of COVID-19, housing costs have continued to rise. This growing unaffordability has serious distributional impacts, with the young, those on low-to-middle incomes, and Māori and Pacific communities among the most severely affected. Housing unaffordability also has substantial flow-on impacts on child poverty.

A range of initiatives have been submitted for Budget 2021, providing options on how to best address this issue, including supply-side measures, and measures specifically targeting Māori.

13 initiatives have been submitted for housing-related initiatives

across the Housing and Urban Development, the Building and Construction, and Māori Development portfolios.

These comprise:

- [33]
-

Largest submitted Housing initiatives

Initiative title	Total opex (\$m)	Total capex (\$m)
Package to increase housing supply and improve affordability	2242	0
Investment to increase housing supply [38] projects [38]	large scale [38]	
Accelerating Immediate Māori Housing Solutions	298	0
Kāinga Ora Sustainable Funding	[33]	

Context for Budget 2021

Climate change

A series of climate policy decisions are coming up in 2021. The Climate Change Commission will present its final advice to the Government by the end of May, meaning that decisions on an Emissions Reduction Plan (ERP) will be made after the Budget is finalised.

Budget 2021 presents opportunities to invest in key measures that will help to progress towards the Government's emissions reduction targets. We will need to consider whether to delay some decisions until after the ERP is completed, though this may cause some delay in delivering action on emissions.

13 initiatives have been submitted as part of a proposed climate package across the Climate Change, Agriculture, Transport, and Energy and Resources portfolios.

These comprise:

- [33] opex [33] of all opex sought)
- [33] capex [33] of all capex sought)

Largest submitted climate initiatives

Initiative title	Total opex (\$m)	Total capex (\$m)
[33]		
Reducing emissions through the Transport Climate Package		[33]
Recapitalising New Zealand Green Investment Finance Ltd		
Implementing the Carbon Neutral Government Programme		

Context for Budget 2021

Child wellbeing

Reducing child poverty remains a Government priority for Budget 2021. The next release of Child Poverty data is scheduled for 23 February 2021, which will show the full impact of the Families Package. We will need to set the next round of three-year targets by 30 June 2021. An income support package as part of Budget 2021 would support meeting the new interim targets.

A meeting between relevant Ministers discussing income support will be scheduled shortly.

Initiatives submitted

The submitted initiative **most likely to have a direct impact on child wellbeing** is the proposed main benefit increase of \$25 per week.

This initiative seeks \$2.2 billion of operating funding across the forecast period. This represents:

- 8% of all opex sought for Budget 2021, and
- 21% of the Budget 2021 operating allowance

If a further increase of \$25 per week in Budget 2022 were submitted, this would cost an estimated further \$2.1 billion (assuming an 1 April 2022 implementation), which is 21% of the operating allowance for Budget 2022. This would amount to a total of approximately \$4.3 billion across two Budgets.

There are likely to be a range of initiatives submitted in other portfolios with direct and indirect impacts on child wellbeing. The Treasury is assessing these impacts and will provide this analysis as part of the advice on a draft Budget package.

Context for Budget 2021

General cost pressures

As in previous Budgets, a significant amount of funding is sought to address cost pressures across the state sector. These include ongoing pressures in the Education and Health portfolios such as maintenance of critical infrastructure, and sustainable funding for District Health Boards.

A key consideration in addressing cost pressures is striking a balance between the immediate need to ensure continuity of service in these areas, and the longer-term need to address the underlying drivers that create these pressures. In the Health portfolio, this could include providing funding to implement the recommendations of the Health and Disability System Review.

Previous funding for cost pressures

Significant funding for cost pressures has been provided over the past two Budgets, with \$11.0 billion over the forecast period in Budget 2020, and \$7.7 billion in Budget 2019.

In Budget 2020, \$3.9 billion opex and \$750 million capex was provided to support District Health Boards. Pressures on DHBs are ongoing, and a further ^[33] is sought in Budget 2021.

Education cost pressure initiatives in Budget 2020 included \$375 million opex to maintain existing service levels in the Education sector, and \$120 million opex and \$115 million capex for investments in school property.

Initiatives submitted in key portfolios

Education

39 initiatives were submitted for the Education portfolio, comprising:

[33]

Largest submitted Education initiatives

Initiative title	Total opex (\$m)	Total capex (\$m)
Funding the Next Phase of the National Education Growth Plan	[33]	
Reform of the Tomorrow's Schools System		
Meeting Cost Increases in Legacy Redevelopment Projects		
Ensuring the viability of vocational education and training	280	0
Purchasing Land for New Schools	[33]	

Health

37 initiatives were submitted for the Health portfolio, comprising:

Largest submitted Health initiatives

Initiative title	Total opex (\$m)	Total capex (\$m)
District Health Boards' Capital Investment	[33]	
Supporting District Health Boards Cost Pressure		
Minimum Infrastructure and Capability Uplift to Enable Transformation		
Supporting Disabled New Zealanders to Live Good Lives		
Implementing the In-Between Travel Settlement		

*An allocation of \$2 billion for Education initiatives was agreed as part of the invitation process. This figure excludes an initiative seeking \$0.3 billion for Holidays Act remediation, which is being considered outside this allocation.

Initiatives submitted in key portfolios

Social Development

24 initiatives were submitted for the Social Development, comprising:

[33]

Māori package

17 initiatives across 9 portfolios were submitted as part of a proposed Māori package.

These initiatives amount to [33]

is sought for Māori housing initiatives.

Largest submitted Social Development initiatives

Initiative title	Total opex (\$m)	Total capex (\$m)
Main Benefit Rate (\$25 per week) Increase and Complementary Changes	2165	0
Reinstatement of the Training Incentive Allowance	203	100
Meeting demand for employment services and products in response to the labour market impacts of COVID-19	[33]	
Ministry of Social Development Remuneration Inflationary Pressure		
Improving Childcare Assistance for low and middle-income families		

Largest submitted Māori initiatives

Initiative title	Total opex (\$m)	Total capex (\$m)
Accelerating Immediate Māori Housing Solutions	298	0
Health and Disability System Review – Measures specifically for Māori	[33]	
Te Pae Oranga iwi community panels: tikanga Māori and Whānau Ora-based alternative to court for low-level offending		

Next Steps

