

The Treasury

Budget 2021 Information Release

August 2021

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Budget Ministers 2

Emerging Budget 2021 Package

16 March 2021

Purpose

The key objectives for this meeting are to:

1. Discuss the **fiscal strategy** for Budget 2021
2. Make decisions on the **emerging Budget 2021 package**, including:
 - a. Options for funding our priority manifesto commitments
 - b. Potential initiatives to receive funding from the COVID-19 Response and Recovery Fund (CRRF)
 - c. Priority packages (Child Wellbeing, Climate Change, Housing)
 - d. Scale of cost pressure funding
3. Provide direction on key **decisions and trade-offs** required among Budget 2021 initiatives and sub-packages, particularly with respect to our manifesto commitments and allowances

Trade-offs and Key Decisions

Decisions on **a number of key questions** are required as we work towards finalising Budget 2021:

1. Given the level of critical cost pressures requiring funding, **how do we want to sequence our manifesto priorities across Budgets 2021 to 2023?**
2. Where do we want to **focus our manifesto priority investment for Budget 2021?** Do we want to focus on one particular priority area or spread investment across priorities?
3. Which **“high” or “low” options should we progress** across our priority areas?
4. Are we prepared to **spend more than the current allowances** to fund our manifesto commitments, noting the corresponding impact on the fiscal position, or should we continue to progress a Budget package within current allowances?
5. Do we want to fund **time-limited COVID-19 Budget initiatives through the CRRF** and/or consider other options to manage pressure on allowances, including reprioritisation and raising revenue?
6. Do we want to explore further **options to scale or defer initiatives** to create more space for investment in our priority areas?

*Following this meeting (and following further bilateral meetings with some of our colleagues), I propose to revise this Budget package and present you with a near-final version at our **next meeting on Monday 29 March**. I intend for us to take decisions on the final Budget package at this meeting.*

Outlook and Fiscal Strategy



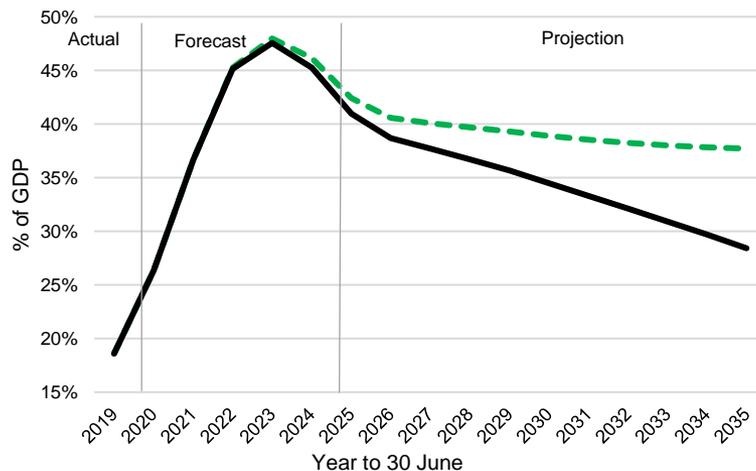
Outlook

- The Treasury is currently in the process of updating its 5-year fiscal forecasts. These will provide an insight into the Government's fiscal outlook ahead of Cabinet decisions on Budget 2021.
- The most recent month-end results show a **lower than expected operating deficit** and a **lower level of net core Crown debt** on the back of **stronger than expected economic growth** compared to the *Half Year Update*.
- The strength in the economy is expected to continue throughout the current year and to flow into future years, though **uncertainty levels remain heightened**. As a result, **tax revenue is forecast to be significantly higher than previously forecast**.
- However, the stronger economic outlook is also likely to result in an **increase in expense forecasts** (such as NZ superannuation payments that are indexed to wage growth). In addition, there is a risk that the **drivers of this strength could create significant cost pressures in the future (such as wage costs)**.
- The Treasury's updated **fiscal forecasts are not due to be completed until 23 March 2021** and will be reflected in the material for Budget Ministers 3. However, based on stronger than expected economic growth, it is likely that both the operating deficit and net core Crown debt tracks will be much lower than previously expected.

Fiscal Strategy

- The improved economic and fiscal outlook is likely to result in debt as a share of the economy falling faster than previously expected. This provides space to increase allowances while maintaining a sustainable fiscal position. **However, the fiscal outlook is highly uncertain and depends on the path of COVID-19.**
- Current forecasts (baseline scenario) assume **operating allowances that require significant trade-offs** and allow little to no space for funding anything beyond immediate cost pressures.
- Operating allowances of around \$3 billion per Budget in the forecast period are likely to be consistent with stabilising debt**, and provide space for funding both cost pressures and a limited number of priority manifesto commitments. **However, remaining within these will still require hard decisions.** Increasing operating allowances beyond this creates concern for fiscal sustainability and for meeting our debt objective.
- Due to **high uncertainty**, it is prudent to retain flexibility to respond to further outbreaks of COVID-19 or a more prolonged recovery.

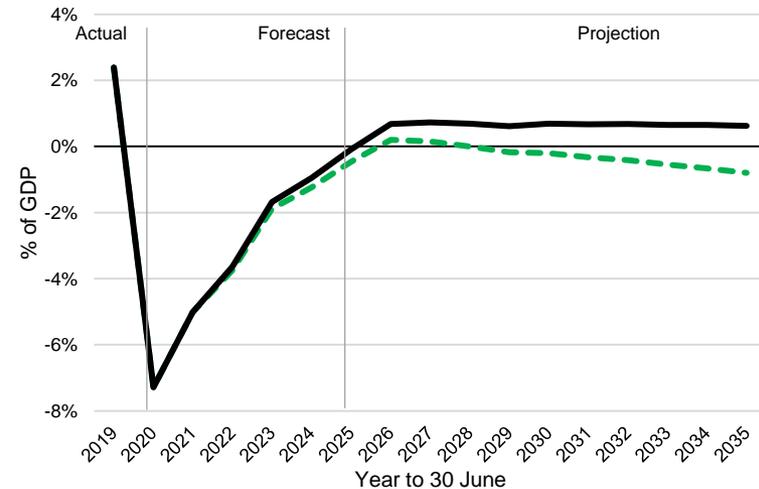
Impact of allowances on net core Crown debt (% of GDP)



Baseline assumptions

- Operating allowances of \$2.625 billion** over the forecast period and **\$2.3 billion** over the projection period (growing at 2% per annum).
- MYCA of \$7.8 billion** over the forecast period and **\$4.0 billion** annual capital allowances over the projection period (growing at 2% per annum).

Impact of allowances on OBEGAL (% of GDP)



Proposed scenario

- Operating allowances of \$3.0 billion** over the forecast period and **\$2.8 billion** over the projection period (growing at 2% per annum).
- A \$4.2 billion top-up of the MYCA to \$12 billion** over the forecast period. **\$4.0 billion** annual capital allowances over the projection period (growing at 2% per annum).

Note: Modelling is based on Half Year Update forecasts updated to include preliminary Budget Update tax and benefit forecasts.

Fiscal Management Options



CRRF Reprioritisation

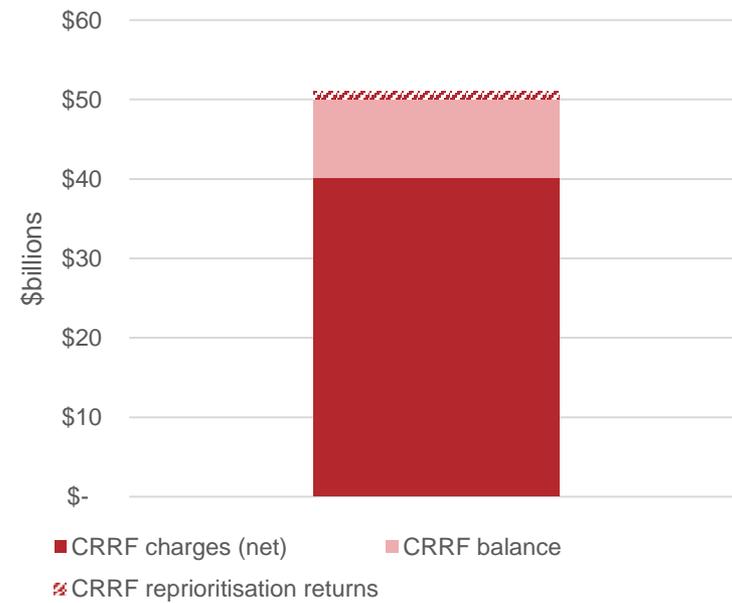
- In total, over the forecast period, I have identified potential **CRRF reprioritisation options of \$1 billion**. This figure comprises the reprioritisation and scaling of some initiatives as well as underspends identified in the 2020/21 financial year.
- Our most important decision concerns what we do with this funding. **I recommend that this funding returns to the CRRF to be reallocated for similar time-limited, COVID-19 related initiatives.**
- Alongside this reprioritisation of allocated CRRF funding, **I will also continue to consult you on other reprioritisation options** – including where underspends are identified as part of this year’s March Baseline Update.

Significant CRRF initiatives for reprioritisation

Portfolio	Title	Total funding FY2020/21 – FY2024/25 (\$m)	Repri. opex total FY2020/21 – FY2024/25 (\$m)	Repri. opex ongoing (\$m per year)
Health	SuperGold card health and eye check	260	260	62
Transport	Supporting NTLF revenue shortfall and meeting COVID costs	500	250	0
Education	Sustaining the Early Learning Network	206	172	0
Education	Critical Funding to Address Supplier Contractual Obligations	89	56	0
Transport	Impacts for Waka Kotahi NZTA Regulatory Memorandum Accounts	60*	[33]	0
Social Dev. and Employment	He Poutama Rangatahi	156	30	0
Tertiary Education	Establishing Workforce Development Councils to Support COVID-19 recovery	295	30	0
Other	19 initiatives not listed above	1,047	152	0
Total		2,611	[33]	62

*This is an MYA and includes FY2019/20 funding.

CRRF – reprioritisation returns



Note: reprioritisation options largely relate to one-off, rather than ongoing, initiatives. Final amount for reprioritisation may differ following final agency consultation. Numbers in tables throughout slides may not sum due to rounding to nearest million.

COVID-19 Response and Recovery Fund

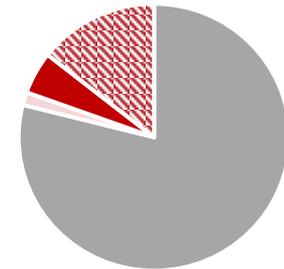
- The **unallocated balance of the COVID-19 Response and Recovery Fund (CRRF) is \$9.8 billion**, with \$800 million in upcoming funding requests (including \$529 million for the continuation of Ka Ora, Ka Ako | Healthy School Lunches).
- A number of initiatives submitted for Budget 2021 have been identified by agencies and the Treasury as candidates for CRRF funding (\$281 million total operating and \$304 million total capital). **These initiatives are excluded from draft Budget package aggregates.** Funding time-limited COVID-19 response and recovery initiatives from the CRRF will help ease pressure on Budget 2021 allowances.
- In addition to these initiatives, I recommend that we also **fund the Housing Infrastructure Fund from the CRRF [38]** and **the Reinstatement of the Training Incentive Allowance** (\$178 million total operating and \$100 million total capital) and a **tourism support initiative** (\$200 million total operating) as part of our ongoing rebuild and recovery from the economic shock of COVID-19.
- [33]

Candidates for CRRF funding

Portfolio	Title	Opex avg (\$m)	Opex total (\$m)	Capex total (\$m)
Housing	Infrastructure Fund	[38]		
Tourism	Tourism Support Initiative*	50	200	-
Social Development and Employment	Reinstatement of the Training Incentive Allowance for Main Benefit Recipients	45	178	100
Social Development and Employment	Meeting demand for employment services and products in response to labour market impacts of COVID-19	25	100	-
Social Development and Employment	Supporting MSD COVID-19 Response by Providing Staff to Respond to New Zealanders Income, Employment and Housing Needs	22	86	-
Pacific Peoples	Expanding Tupu Aotearoa to Support Pacific Peoples	8	30	-
[33]				
Immigration	Financial Sustainability: Third Party Revenue Replacement Funding	-	-	173
Customs	Financial Sustainability: Third Party Revenue Replacement Funding	[33]		
Other	9 initiatives not listed above	11	44	56
Total for CRRF		377	1,509	1,104

*Proposal under development.

CRRF – charges and balance*



- Allocated
- Upcoming non-Budget 2021 charges
- Potential Budget 2021 CRRF charges
- ▨ Available (excluding upcoming charges)

Key question: Are we comfortable funding these initiatives through the CRRF, rather than through Budget allowances?

Note: Allocated balance is net, inclusive of \$1 billion return agreed through Budget Strategy Cabinet Paper (CAB-20-MIN-0483). Unallocated balance includes \$1 billion of reprioritised funding to be returned to CRRF.

Emerging Budget 2021 Package

Emerging Package – Approach

- The **emerging Budget 2021 package** consists primarily of a **minimum viable package to fund critical cost pressures** (\$2.2 billion average operating per annum).^{*} Additionally, we have options for how we choose to sequence our priority manifesto commitments across the next three Budgets.
- Initiatives have been assessed by the Treasury, and ratings provided, based on: (1) **contribution to our Budget priorities**, (2) **value for money**, and (3) **implementation readiness**.
- I have also provided you a **slide pack of supplementary material** that provides an overview of the wellbeing analysis undertaken for Budget 2021 as well as system-level perspectives provided by the Government Chief Digital Officer (**GCDO**), the Government Chief Data Steward (**GCDS**) and the **Capital Panel**.
- A number of key strategic choices remain, including **whether cost pressures should be funded above a minimum viable level** as well as the extent to which we choose to **fund manifesto commitments now or in future Budgets**. It is important that we address these trade-offs now to enable us to agree a near-final Budget 2021 package at our next meeting on 29 March 2021.

^{*}Excluding nine cost pressures better considered alongside our three key priority areas (child wellbeing, housing, and climate change), and which are incorporated in these packages respectively. These total \$50 million operating per annum and \$320 million capital (“high”) or \$31 million operating per annum and \$200 million capital (“low”).

Emerging Package – Headline Figures

- The **emerging Budget 2021 cost pressure package** totals **\$2.2 billion average operating** per annum and **\$1.8 billion capital total**. This cost pressure package **fits within current allowances** (\$2.625 billion operating per annum and \$7.8 billion* capital total). In addition, I have **included nine relevant cost pressures in the priority area sub-packages**, for which I have provided high and low options. These total \$50 million average operating per annum, \$320 million capital total (high); \$31 million average operating per annum, \$200 million capital total (low).
- When considered alongside manifesto commitments, **allowances are significantly oversubscribed**. We can only fund critical cost pressures and a limited number of key manifesto commitments within current allowances. As outlined on previous slides, we may wish to ease pressure on allowances by funding time-limited, COVID-19 related costs through the CRRF or by progressing savings, revenue or reprioritisation options.
- Even if we **increase allowances**, we still have critical decisions to make about where to focus investment with respect to our manifesto priorities. **Difficult trade-offs are required** to develop a final Budget package. Accordingly, I have developed “low” and “high” options across our manifesto priority areas of child poverty, climate change and housing, and identified other time-sensitive and high-value manifesto commitments that we may want to prioritise for funding this Budget.

Breakdown of emerging packages...

\$ millions	Operating p.a.		Capital total	
	Low Options	High Options	Low Options	High Options
Precommitments	203		11	
Cost Pressures	2,152		1,802	
Manifesto – Child Poverty	586	1,195	0	51
Manifesto – Climate Change	47	93	216	336
Manifesto – Housing	58	82	1,163	2,300
Manifesto – Other	[33]		1,134	
Between-Budget Contingency	40		-	
Emerging Priorities Contingency	-		-	
Budget 2021	[33]		4,326	5,634

Note: All data used in slides is accurate as at Tuesday 9 March 2021 and may not include late initiatives.

Overall...

\$ billions	Operating p.a.	Total capital
Total Submitted	7.1	13.2
CRRF Initiatives (incl. Housing)	0.4	1.1
Draft High Options**	4.2	5.6
Draft Low Options**	3.5	4.3
Budget 2021 allowances (after precommitments)	2.4	7.8*

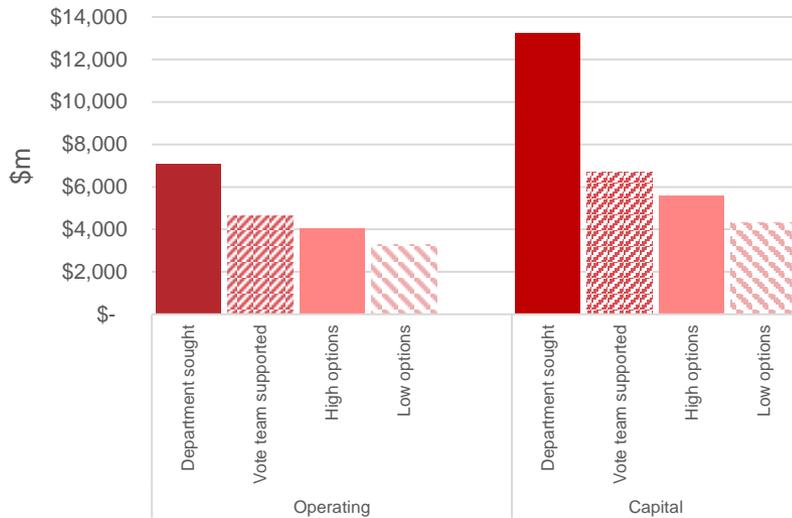
Key question: Where should we choose to focus our new spending over and above funding critical cost pressures?

*MYCA for Budgets 2021 to 2024.

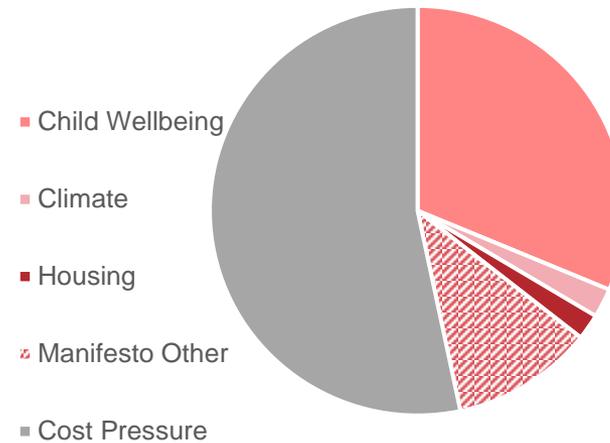
**Includes agreed precommitments and BBC.

Emerging Package – Headline Figures

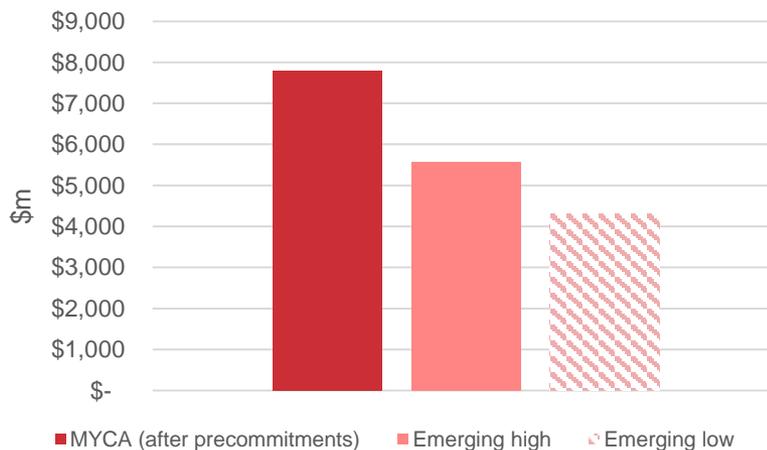
Emerging package – funding sought and recommended



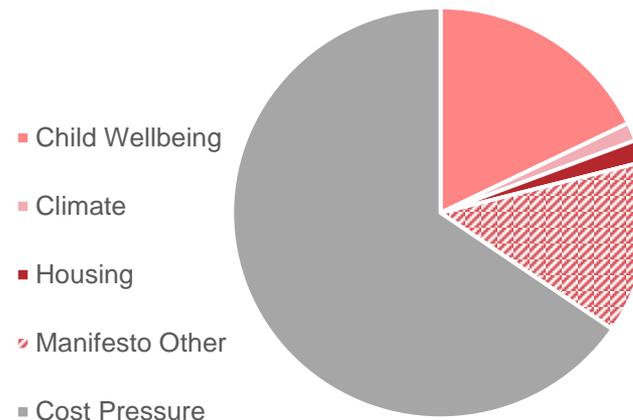
Emerging package – high options (average per annum)



Emerging package – Capital vs MYCA*



Emerging package – low options (average per annum)



Charts relate to new Budget 2021 initiatives only and exclude initiatives for CRRF funding.
*MYCA for Budgets 2021 to 2024.

Key Questions

I have **three key questions** for you as we review options for the emerging Budget 2021 package:

1. Given pressures on allowances, **to what extent do we choose to fund priority manifesto commitments** at Budget 2021 over and above meeting our minimum cost pressure obligations?
2. Where should we **focus our investment** for priority manifesto commitments at Budget 2021?
3. How do we balance a preferred Budget package (likely to be above current allowances) against **fiscal sustainability** and our fiscal strategy?

Manifesto Priorities

Manifesto Spending Options

In addition to a **Budget package that funds critical cost pressures** within current allowances, we have a number of options with respect to our priority manifesto commitments:

- I have developed **three priority area sub-packages** (Child Wellbeing, Climate Change and Housing) as well as a **Manifesto – Other sub-package**.
- For the priority area sub-packages, I have **developed both “high” and “low” alternatives** that reflect our options for funding these manifesto priorities.
- We may wish to focus on a single priority area, fund initiatives across priority areas, or progress a **combination of the above**.
- The decisions that we take with respect to these options will affect whether we progress with a Budget package that stays **within current allowances** or one that requires a **modest or large increase to these allowances** at Budget 2021 and/or across the forecast period, as well as the extent to which we may choose to progress with other savings and reprioritisation options.

Priority Area – Child Wellbeing

- Addressing child poverty and **improving child wellbeing** is a priority area for Budget 2021. **Income support is a key lever** to make progress towards our child poverty targets.
- The draft “low” and “high” priority options that I have developed incorporate a number of **manifesto commitments** as well as **five relevant cost pressure initiatives**.*
- The **cornerstone of each option is our commitment to increase main benefits**. In the “low” option, a \$25 per week per adult increase (from 1 July 2021) is charged against the Budget 2021 operating allowance. The “high” option reflects a two-stage \$50 per week per adult increase (\$25 per week from 1 July 2021 and a further \$25 from 1 April 2022; \$949 million average operating per annum) charged against the Budget 2021 operating allowance, alongside a \$25 per week increase in student support.**

Significant manifesto – Child Wellbeing initiatives

Portfolio	Title	Low		High	
		Opex avg (\$m)	Capex total (\$m)	Opex avg (\$m)	Capex total (\$m)
Social Development	Main Benefit Rate Increase and Complementary Changes (high includes \$25 increase in student allowances)	541	-	1,039 [^]	50 [^]
Justice	Preventing FVSV: Sustain and develop existing safety responses with communities	[33]	-	[33]	-
Police	Te Pae Oranga iwi community panels: alternative to court for low-level offending	10	-	18	-
Justice	Safeguarding child wellbeing and building a strong foundation for change in the family justice system	3	-	4	-
Social Development	Improving Childcare Assistance for low and middle-income families	3	-	3	-
Other	11 child wellbeing initiatives not listed above	8	-	52	1
Total package		586	0	1,195	51

Key question: Are we still supportive of progressing with a \$50 per week per adult main benefit increase at Budget 2021?

*The Treasury considers that these cost pressures are more appropriately considered in the context of this priority area, and these total \$30 million average operating per annum (high) or \$27 million average operating per annum (low).

**Income Support Ministers met on 9 March. At this stage there is in-principle agreement to a \$25 increase in student allowances as part of the two-stage main benefit increase.

[^]Costings are preliminary, and also subject to change based on decisions around Budget allowances. These will be updated and reflected in the emerging package ahead of Budget Ministers 3.17

Priority Area – Climate Change

- The Climate Change Commission draft report has confirmed that we are **not on track to meet our emissions targets**.
- Budget 2021 is an opportunity to start making progress towards these targets, but will not be sufficient in and of itself. Compounding this, **initiatives submitted in this manifesto priority area are generally not implementation-ready**, or have been identified as low value for money. For high-value initiatives, scaling has been used to fund policy development ahead of Budget 2022. As with the child wellbeing sub-package, this sub-package includes **four relevant cost pressure initiatives**.*
- As a first step, **I am only recommending targeted investment in those initiatives that are implementation-ready**, representing the highest value-for-money [33]
- Minister Shaw has proposed hypothecating ETS revenues for climate initiatives, but this has not been supported by the Treasury.

Significant manifesto – Climate Change initiatives

Portfolio	Title	Low		High	
		Opex avg (\$m)	Capex total (\$m)	Opex avg (\$m)	Capex total (\$m)
Climate Change	Recapitalising New Zealand Green Investment Finance Ltd	-	200	-	300
Energy and Resources	Extending the Warmer Kiwi Homes Programme	25	-	30	-
Climate Change	Implementing the Carbon Neutral Government Programme	2	-	13	20
Transport	Reducing Emissions through the Transport Climate Package	10	16	10	16
Other	<i>8 climate change initiatives not listed above</i>	10	-	40	-
Total package		47	216	93	336

Key question: Are we willing to defer many of the climate change initiatives to enable a better package to be developed for Budget 2022?

*The Treasury considers that these cost pressures are more appropriately considered in the context of this priority area, and these total \$20 million average operating per annum and \$320 million capital total (high) or \$4 million average operating per annum and \$200 million capital total (low).

Priority Area – Housing

- Housing is a key determinant of wellbeing, and improving the fundamental affordability of housing will be necessary to achieve objectives in areas like child poverty. Investment alone will be insufficient to improve housing affordability at scale. To achieve this, **spending should be paired with short and long-term regulatory levers and reforms**, including through our Resource Management Act reforms.
- If agreed, a Cabinet paper, “Increasing Housing Supply and Improving Affordability for First Home Buyers and Renters”, will **delegate decision-making on a housing package to us as Budget Ministers**, as well as make a precommitment of \$12.3 million operating per annum to increase the house price caps for First Home Products for both existing and new properties.
- The **“low” options I have provided focus on initiatives where there is limited discretion around funding decisions**, such as the large-scale programmes (LSPs), while the “high” options propose more ambitious solutions.

Significant manifesto – Housing initiatives

Portfolio	Title	Low		High	
		Opex avg (\$m)	Capex total (\$m)	Opex avg (\$m)	Capex total (\$m)
Housing	Infrastructure Fund*	[38]			
Housing	[38] Large Scale Projects (LSPs)	-	[38]		
Housing	[38]	-	[38]	-	[38]
Housing	Accelerating Immediate Māori Housing Solutions	56	-	75	-
Housing	Ensuring compliance with the Healthy Homes Standards	2	-	4	-
Total package	<i>Excluding Infrastructure Fund</i>	[38]			
Total package	<i>Including Infrastructure Fund</i>				

Key question: How can we pair regulatory and fiscal levers to reach our housing affordability goals?

*To be funded through the CRRF. **Note:** following Cabinet’s consideration of the Cabinet paper, the funding amounts for these initiatives, as well as the source of this funding, may change. The above figures are estimates as at 9 March 2020.

Distributional impacts

In their current form, **these options will not have a transformational impact on New Zealand’s housing outcomes**. Even with the “high” package, housing outcomes for non-home-owning New Zealanders, among whom **Māori and Pacific peoples are heavily overrepresented**, are likely to continue to deteriorate.

Several initiatives do target communities facing poorer housing outcomes, particularly Māori and Pacific peoples:

- [33]
- [33] LSPs – targets urban Māori and Pacific communities
- [38]

While these investments represent a promising start, they have limited scalability.

We may wish to consider:

- [33]
- Attaching conditions around partnering with Māori and iwi to the proposed Infrastructure Fund

Cost Pressure Package

A large, solid red triangle is positioned in the bottom right corner of the slide, pointing towards the top right. The rest of the slide background is white.

Emerging Package – Operating Cost Pressures

- I have developed a **minimum viable cost pressure package that fits within allowances**. We may also wish to invest further in funding cost pressures, given the risks associated with some minimum viable options. The next slide outlines a number of cost pressures excluded from this package. I am considering some relevant cost pressures within priority area sub-packages.
- As in previous years, **cost pressures make up the majority of the Budget 2021 package**. This reflects a number of drivers, including legislative changes we have made, price and volume increases, and the fact that funding for cost pressures in recent Budgets has been time-limited or scaled, increasing costs in future years.
- Cost pressures in Health (51%) and Education (10%) make up a considerable part of the operating cost pressure package. Overall, **we are facing very large operating cost pressures across a number of portfolios**, with limited discretion.
- Large one-off, time-limited items** include funding to eradicate *M. bovis* [33] and [37,38]

Significant operating cost pressure initiatives

Portfolio	Title	Opex avg (\$m)	Opex total* (\$m)
Health	Supporting District Health Boards Cost Pressure	[33]	
Health	Disability Support Services – Cost Pressure	84	338
[37,38]			
Education	Holiday’s Act Remediation for School and Ministry Payroll	68	270
Justice	Continued Legal Aid funding: maintaining legal representation for participants who cannot afford legal services	[33]	
Social Development	Remuneration Increases for MSD Staff as a Result of Collective Bargaining	[33]	
[33]			
Economic and Regional Development	New Zealand Screen Production Grant – International	50	199
Health	Primary Care Cost and Volume Pressures	47	187
Education	Ensuring the viability of vocational education and training	34	137
Other	106 operating cost pressure initiatives not listed above, excluding priority area cost pressures**	927	3,709
Total		2,152	8,609

*Over the 2020/21 to 2024/25 forecast period. **May not include late initiatives.

Emerging Package – Capital

- Capital cost pressures in **Health, Education and Transport** make up a considerable part of the capital cost pressure package. Overall, the Government is facing very large unavoidable capital cost pressures across a number of portfolios.
- Capital initiatives** included in the emerging Budget 2021 cost pressure package **total \$1.8 billion**. We may also wish to invest in capital cost pressures further to what I have included in this draft package. However, when adding supported manifesto capital initiatives, our **options for funding capital projects total \$5.6 billion (high) or \$4.3 billion (low)**.* This compares to a multi-year capital allowance (MYCA) of \$7.8 billion to be allocated across Budgets 2021 to 2024 (not including any potential top-ups).
- I also note that only [33] largest and riskiest capital initiatives (across manifesto priorities and cost pressures) have a completed business case available.

Significant capital cost pressure initiatives

Portfolio	Title	Capex total (\$m)
Health	District Health Boards' Capital Investment	[33]
Education	Meeting Cost Increases in Legacy Redevelopment Projects	150
Transport	Capital to fund Cabinet-agreed investment in Aviation Security Infrastructure and Regulatory Systems	113
Health	Hira programme (previously referred to as the national Health Information Platform)	[33]
Transport	Future of Rail – Core Asset Management	87
Education	Purchasing Land for New Schools	85
Health	Investment in foundational data and digital infrastructure and capability to enable Health System transformation	[33]
Other	26 capital cost pressure initiatives not listed above, excluding priority area cost pressures	447
Total		1,802

Key question: To what extent do we want to defer capital initiatives that are not considered investment ready, as opposed to holding funding in contingency?

Cost pressures excluded from package

I would also like to highlight the cost pressures, both operating and capital, that have **not been included in the emerging package**. In total, 34 submitted cost pressure initiatives have either not been supported or have been recommended for deferral.

Portfolio	Assessment	Title	Opex avg sought (\$m)	Opex total sought (\$m)	Capex total sought (\$m)
[33]					
Education	Defer	Funding the Next Phase of the National Education Growth Plan	[33]		
[33]					
Education	Defer	Improving the Property at State-Integrated Schools	13	53	-
Other	-	30 other cost pressure initiatives not in package	90	358	15
Other	Scaled	Quantum of funding scaled from cost pressures included in packages**	1,097	4,389	4,921

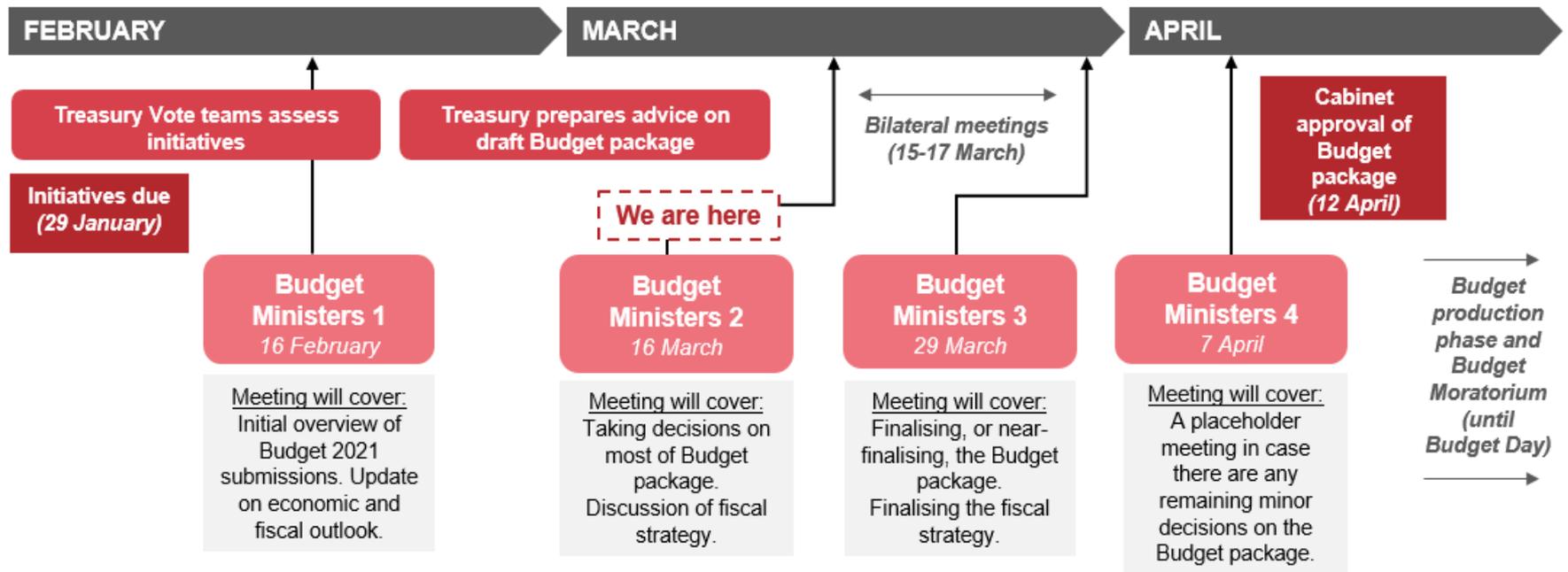
*Excluding initiatives to be funded through the CRRF.

**Includes CRRF initiatives.

Next Steps



Next Steps



Key question: As the Budget 2021 package is refined further, where would you like to see more work? Is there any information that you would like highlighted at our next meeting?