

# The Treasury

## Budget 2021 Information Release

### August 2021

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- [1] 6(a) - to avoid prejudice to the security or defence of New Zealand or the international relations of the government
- [23] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information
- [26] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied
- [33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment
- [36] 9(2)(h) - to maintain legal professional privilege
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [40] Not in scope
- [42] 18(d) - information is already publicly available or will be publicly available soon.

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## Treasury Report: Immediate fiscal strategy decisions

<b>Date:</b>	5 November 2020	<b>Report No:</b>	T2020/3342
		<b>File Number:</b>	MC-1-8

### Action sought

	Action sought	Deadline
Hon Grant Robertson <b>Minister of Finance</b>	<p><b>Agree</b> to the recommendations on:</p> <ul style="list-style-type: none"> <li>assumed allocations against the COVID-19 response and recovery fund</li> <li>the size of operating and capital allowances, and</li> <li>contributions to the New Zealand Superannuation Fund.</li> </ul> <p><b>Refer</b> this report to the Prime Minister and Associate Ministers of Finance.</p>	Tuesday 10 November

### Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Andrew Rutledge	Chief Advisor to the Secretary, Corporate and Shared Services	[39]	✓
Suzie Harrison	Senior Analyst, Macroeconomic and Fiscal Policy	n/a (mob)	
Angus Hawkins	Team Leader, Macroeconomic and Fiscal Policy	n/a (mob)	

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

**Return** the signed report to the Treasury.

**Refer** this report to the Prime Minister and Associate Ministers of Finance, subject to the Minister of Finance's agreement.

Note any feedback on the quality of the report

**Enclosure:** No

# Treasury Report: Immediate fiscal strategy decisions

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## Executive Summary

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This report seeks urgent fiscal strategy decisions in order to finalise the *Half-Year Economic and Fiscal Update* (HYEFU) forecasts. These decisions are on:

- assumed allocations against the COVID-19 response and recovery fund (CRRF)
- the size of operating and capital allowances for Budgets 2021 to 2024, and
- contributions to the New Zealand Superannuation Fund (NZSF).

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

Labour's *Fiscal Strategy* document allocated around \$2.3 billion<sup>1</sup> of the remaining balance of the CRRF. Beyond this, based on your intentions to not spend the CRRF "unless absolutely necessary", we have formed a judgement that much of the remaining unallocated balance of the CRRF should be excluded from our HYEFU forecasts.

However, we are aware of upcoming COVID-related policy decisions that could have significant fiscal costs – eg for public health measures and managed isolation and quarantine facilities. We expect further COVID-related expenses of approximately \$2.7 billion will need to be included in the HYEFU forecasts (note this figure is a rough estimate and has not been fully scrutinised or discussed with the relevant agencies), and we recommend these be assumed to be allocated against the CRRF.

### **Operating Allowances**

We assume you want to increase operating allowances to \$2.625 billion per year in line with Labour's *Fiscal Strategy*. Based on pre-COVID-19 trends, it is likely to be challenging to meet both your manifesto commitments and cost pressures within this allowance.

The operating allowances in Labour's *Fiscal Strategy* included revenue from changes to personal income tax and digital tax. However, we propose to include only the former in the HYEFU forecasts, and to exclude the latter due to uncertainties regarding costing and implementation. The digital tax revenue was estimated at \$80 million per year, so its exclusion will not substantively affect the fiscal indicators.

### **Multi-Year Capital Allowance**

We are assuming you want to increase the Multi-Year Capital Allowance (MYCA) to \$7.8 billion in line with Labour's *Fiscal Strategy*. Note that agencies' capital intentions indicate that demand for capital expenditure will be higher than this, at \$16 to 22 billion over the next four Budgets. Keeping spending within this allowance will therefore be challenging. To support this, we recommend ring-fencing a portion of the MYCA for future Budgets to ensure funding availability is better matched to the pipeline of high-value projects.

### **New Zealand Superannuation Fund Contributions**

Labour's *Fiscal Strategy* did not indicate a change to the current approach to contributions. In June you indicated your preference was to consider options for changing the approach at Budget 2021. We recommend you stick to this timeline and make no change at HYEFU.

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<sup>1</sup> This number also assumes the \$0.3bn spending on the flexi-wage is allocated to the CRRF, rather than operating allowances, given this is temporary COVID-19 spending.

## **Short-Term Intentions and Long-Term Objectives**

The PFA requires you to explain in the *Budget Policy Statement* (BPS) – typically published alongside HYEUFU – how Budget 2021 will accord with the current short-term intentions ('intentions' hereafter) set out at Budget 2020, or to set out new intentions. The allowances proposed above are consistent with your current intentions. However, we recommend setting out new intentions and long-term objectives at the BPS to help shape your fiscal strategy and provide greater clarity about how you intend to keep debt under control. We will provide you further advice on this.

## **Recommended Action**

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We recommend that you:

### COVID-19 Response and Recovery Fund

- a **note** we have interpreted your *Fiscal Strategy* commitment on the CRRF (to hold this in reserve “should another outbreak of the virus occur” and “not spend this contingency unless we absolutely need to”) to mean the unallocated balance will only be spent if there is a resurgence of the virus, or for unavoidable COVID-19 related cost pressures.
- b **note** that we have assumed allocation of an additional \$2.3 billion from the CRRF as signalled in your *Fiscal Strategy*
- c **note** that we expect further COVID-related expenses of approximately \$2.7 billion will need to be allocated over the next two financial years
- d **agree** to assume a total of \$5.0 billion further spending against the CRRF in HYEUFU economic and fiscal forecasts

*Agree/disagree.*

- e **note** that the remaining unallocated CRRF spending will be removed from the HYEUFU economic and fiscal forecasts

*Agree/disagree.*

### Operating Allowances

- f **agree** to set operating allowances at \$2.625 billion per year for Budgets 2021 to 2024

*Agree/disagree.*

- g **note** that we propose to include revenue from planned changes to personal income tax in the HYEUFU forecasts, and to exclude revenue from changes to digital tax

### Multi-Year Capital Allowance

- h **agree** to set the multi-year capital allowance at \$7.8 billion for Budgets 2021 to 2024

*Agree/disagree.*

- i **agree** to receive advice on ring-fencing a portion of the multi-year capital allowance for future Budgets

*Agree/disagree.*

*New Zealand Superannuation Fund Contributions*

- j **agree** to make no change to the current approach to NZSF contributions at the HYEUFU

*Agree/disagree.*

*Short-Term Intentions and Long-Term Objectives*

- k **note** we will provide you with advice on setting new short-term intentions and long-term objectives for the *Budget Policy Statement*

*Other*

- l **refer** this report to:

- Rt Hon Jacinda Ardern, Prime Minister

*Refer/not referred.*

- Hon Dr Megan Woods, Associate Minister of Finance

*Refer/not referred.*

- Hon David Parker, Associate Minister of Finance

*Refer/not referred.*

Angus Hawkins  
**Team Leader, Macroeconomic and Fiscal Policy**

Hon Grant Robertson  
**Minister of Finance**

## Treasury Report: Immediate fiscal strategy decisions

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### Purpose of Report

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1. This report seeks fiscal strategy decisions required to allow the Treasury to finalise the 2020 *Half-Year Economic and Fiscal Update* (HYEFU) forecasts. These decisions are on:
  - assumed allocations against the COVID-19 response and recovery fund (CRRF)
  - the size of operating allowances for Budgets 2021 to 2024
  - the size of the multi-year capital allowance (MYCA) for Budgets 2021 to 2024, and
  - contributions to the New Zealand Superannuation Fund (NZSF).
2. Our substantive fiscal strategy advice will be provided in the coming weeks. This report assumes you wish to implement the spending plans in Labour's *Fiscal Strategy* document.

### Context

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3. The Public Finance Act 1989 ('the PFA') requires you to present the HYEFU to Parliament before 31 December 2020.
4. To prepare the HYEFU for release in December, we require your decisions on any significant policy changes by 10 November so that these can be incorporated into the final economic forecasts. As discussed in our advice on HYEFU timelines (T2020/3318 refers), decisions by this date are required to enable a consistent set of economic and fiscal forecasts to be published in December.

### COVID-19 Response and Recovery Fund

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5. The HYEFU forecasts will need to include a judgement on the economic and fiscal impact of the Government's COVID-related measures.
6. The PREFU forecasts included \$35.9 billion of CRRF allocations and assumed that the unallocated balance of \$14.1 billion would be fully allocated by the end of the forecast period.
7. Labour's *Fiscal Strategy* allocated another \$2.3 billion<sup>2</sup> of the CRRF towards an extension to the Small Business Cashflow Scheme, Training Incentive Allowances and Small Business Voucher Scheme. It also indicated that the balance of the CRRF would be held in reserve "should another outbreak of the virus occur" and committed to "not spending this contingency unless we absolutely need to". We have interpreted this as meaning that the unallocated balance of the CRRF will only be allocated if there is a resurgence of the virus, or for unavoidable COVID-19 related cost pressures.

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<sup>2</sup> This number also assumes the \$0.3bn spending on the flexi-wage is allocated to the CRRF, rather than operating allowances, given this is temporary COVID-19 spending.

8. Based on this interpretation, we have formed a judgement that much of the unallocated CRRF balance should be excluded from the HYEUFU forecasts. Our judgement is consistent with our preliminary economic forecasts that do not assume a resurgence of the virus. Although the unallocated balance of the CRRF is excluded from the forecasts, this would not prevent you from committing funding in the event of a resurgence – but any such commitments would then directly affect the fiscal indicators.
9. We are also aware that there are upcoming policy decisions that could have significant fiscal costs – eg public health measures and managed isolation and quarantine facilities. We expect this to cost to be around \$2.7 billion over the next two years (note this figure is a rough estimate and has not been fully scrutinised or discussed with the relevant agencies). Although these do not relate to a resurgence of the virus, given the size of the costs we recommend you manage these against the unallocated portion of the CRRF. There are likely to be on-going funding requests relating to cost pressures as a result of COVID-19, and we can provide advice to you on a process for such requests as part of developing the 2021 Budget Strategy and process.
10. We therefore propose to assume \$5.0 billion of further unallocated spending from the CRRF in the HYEUFU. This is the sum of the additional \$2.3 billion from your *Fiscal Strategy* and \$2.7 billion for public health measures and managed isolation. This is in contrast to \$14.1 billion of unallocated spending assumed in PREFU. This means there will be a reduction of around \$9.0 billion in our forecasts for assumed Government COVID-19 fiscal support compared to PREFU. The amount included in the fiscal forecasts will be further refined as we get better information on policy costings, therefore it may differ to the assumption used in our economic forecasts. Note that removing this \$9.0 billion unallocated spending will, all else equal, result in a weaker economic forecast.

(\$ billion)	20/21	21/22	22/23	23/24	Total
<b>Unallocated CRRF spending assumed at PREFU</b>	<b>7.0</b>	<b>3.6</b>	<b>1.8</b>	<b>1.8</b>	<b>14.1</b>
Manifesto costs in Labour's <i>Fiscal Strategy</i> (including flexi-wage scheme)	1.1	0.8	0.2	0.1	2.3
Upcoming COVID-19 related costs likely to be reflected in HYEUFU	1.0	1.7	-	-	2.7
<b>Indicative unallocated CRRF spending assumed in HYEUFU</b>	<b>2.5</b>	<b>2.5</b>	<b>0.2</b>	<b>0.1</b>	<b>5.0</b>

*Note: totals may not sum due to rounding.*

11. Alternatively, we could include the full unallocated balance of the CRRF in the HYEUFU forecasts, if the intention is to use it more widely than as a reserve for any resurgence of the virus. In order to incorporate this into the forecasts we would need more details on how the funding would be applied.

## Operating Allowances

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12. The HYEUFU forecasts will include the levels of operating allowances for Budgets 2021 to 2024. We assume you want to increase operating allowances to \$2.625 billion per year in line with Labour's *Fiscal Strategy*. These were based on the allowances in the PREFU, plus additional revenue from tax changes.
13. Based on pre-COVID-19 trends, it is likely to be challenging to meet both your manifesto commitments and cost pressures within this allowance. Identifying savings is one way to help reduce the challenge, although difficult decisions are nonetheless

likely to be required. We can provide further advice on options to support you on meeting these challenges and embedding the Wellbeing approach to the Budget.

14. The level of operating allowances in the *Fiscal Strategy* included revenue from changes to personal income tax and digital tax. However, we propose to include only the former in the HYEFU forecasts, and to exclude the latter. This is because revenue from digital tax depends on the outcome of ongoing discussions at the OECD, so there remain substantial uncertainties regarding its revenue. The digital tax revenue was estimated at \$80 million per year, so its exclusion from the forecasts will not substantively affect the fiscal indicators. You will receive separate advice on the costing of the personal tax changes.

## Multi-Year Capital Allowance

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15. The HYEFU forecasts will include the level of the MYCA for Budgets 2021 to 2024.
16. Labour's *Fiscal Strategy* indicated plans to increase the MYCA to \$7.8 billion. This was based on the \$4.8 billion currently in the MYCA, plus \$3 billion of new expenditure that the PREFU projections assumed would be added to the MYCA for Budget 2024.
17. Agencies' capital intentions indicate that demand for capital expenditure over the next four years will be higher than this, at \$16 to 22 billion. This estimate takes into account historic under-reporting by agencies as well as the risk of increased construction costs driven by COVID-19 border restrictions.
18. We recommend ring-fencing a portion of the MYCA for Budgets 2022 to 2024 to better manage these future demands within the available funding, and ensure it is better matched to the pipeline of high-value projects. Although the MYCA can provide greater flexibility on capital allocation, it has been consistently front-loaded in the past. 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. Without change, this will continue. We can provide you with further advice on this.
19. You may also wish to increase the MYCA further to manage these pressures. This remains an option for Budget 2021, but unless otherwise agreed by early next week we will assume a MYCA of \$7.8 billion for HYEFU.

## New Zealand Superannuation Fund Contributions

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20. The HYEFU forecasts will include any changes to contributions to the NZSF.
21. Your planned contributions to the NZSF as at PREFU are shown below. Contributions for 2020/21 and 2021/22 are based on Labour's 2017 Fiscal Plan. Contributions for future years are based on the legislated formula and will be updated at HYEFU based on revised forecasts. Labour's *Fiscal Strategy* did not indicate any change to this approach.

(\$ billion)	20/21	21/22	22/23	23/24
Planned contributions	2.1	2.4	1.4	1.8
Legislated contributions (as prescribed by NZSF model formula)	0.7	1.1	1.5	1.9

22. Due to the fall in forecast GDP, currently planned contributions for 2020/21 and 2021/22 are higher than required by the legislated formula. In June we provided you with advice on options to address this (T2020/1904 refers). In response you indicated your preference was to revisit the issue at Budget 2021, when we will have a better idea of the state of the economy. We recommend you stick to this timeline and make no changes to the current contributions approach at the HYEFU.

**Short-Term Intentions and Long-Term Objectives**

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- 23. The PFA requires the Government to outline its fiscal strategy by setting out short-term intentions ('intentions' hereafter) – covering at least the current year and the next two years – and long-term objectives ('objectives' hereafter) – covering at least the next ten years – for debt, the operating balance, expenses, revenue and net worth.
- 24. The PFA requires you to explain in the *Budget Policy Statement* (BPS) – typically published alongside the HYEFU – how Budget 2021 will accord with the current short-term intentions set out at Budget 2020, or to set out new intentions. We expect your proposed budget allowances to remain consistent with the current intentions and objectives.
- 25. Annex A includes the full list of intentions and objectives from Budget 2020. The key ones were:

<b>Short-term Intentions</b>	<i>Debt</i>	Allow the level of net core Crown debt to rise in the short term.
	<i>Operating balance</i>	Run operating deficits in the short term.
<b>Long-term Objectives</b>	<i>Debt</i>	Stabilise and then reduce net core Crown debt to prudent levels over the long term (subject to any significant shocks) and beyond.
	<i>Operating balance</i>	Return the operating balance (before gains and losses) to surplus over the long term.

- 26. [36]
- 27. Labour's *Fiscal Strategy* did not set out new intentions or objectives, but did set out principles for fiscal management, including: "We will continue to carefully manage the Government's finances and keep debt under control".
- 28. We recommend setting out new intentions and objectives at the BPS to help shape your fiscal strategy and provide greater clarity about how you intend to keep debt under control. These new targets should be carefully designed to balance the priorities of macroeconomic stability in the short term and sustainable public finances over the longer term.
- 29. We will provide you with further advice on these and other options for new intentions and objectives. Alternatively, you may wish to retain the current intentions and objectives at the BPS and reconsider them at Budget 2021. Decisions on any changes will be required by mid-November so that these can be incorporated into the BPS.

## Annex A – Budget 2020 Short-Term Intentions and Long-Term Objectives

<b>STIs</b>	<i>Debt</i>	Our intention is to allow the level of net core Crown debt to rise in the short term to fight COVID-19, cushion its impact and position New Zealand for recovery.
	<i>Operating balance</i>	Our intention is to run operating deficits in the short term to fight COVID-19, cushion its impact and position New Zealand for recovery. We can do this because of our strong starting position and low net core Crown debt going into this pandemic.
	<i>Expenses</i>	Our intention is to ensure expenses are consistent with the operating balance objective.
	<i>Revenue</i>	Our intention is to ensure revenue is consistent with the operating balance objective.
	<i>Net worth</i>	Our intention is to use the Crown's net worth to fight COVID-19, cushion its impact and position New Zealand for recovery. Significant risks will be transferred onto the Crown's balance sheet through the response period.
<b>LTOs</b>	<i>Debt</i>	The Government will stabilise and then reduce net core Crown debt to prudent levels over the long term (subject to any significant shocks) and beyond. Prudent levels of net core Crown debt are those that are within sustainable limits and provide a buffer for future shocks.
	<i>Operating balance</i>	The Government will return the operating balance (before gains and losses) to surplus over the long term and maintain an operating balance consistent with the debt objective thereafter.
	<i>Expenses</i>	The Government will ensure operating expenses support a responsible and proportionate role for the Government in maintaining a productive, sustainable and inclusive economy, consistent with the debt and operating balance objectives.
	<i>Revenue</i>	The Government will ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy, consistent with the debt and operating balance objectives.
	<i>Net worth</i>	The Government will use the Crown's net worth to maintain a productive, sustainable and inclusive economy, consistent with the debt and operating balance objectives.