

# The Treasury

## CAB-19-SUB-0215 Establishing an Independent Fiscal Institution

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Office of the Minister of Finance  
Office of the Associate Minister of Finance  
Chair, Cabinet Economic Development Committee

## Establishing an Independent Fiscal Institution

### Proposal

1. This paper proposes establishing an independent fiscal institution (IFI). The paper proposes the functions the IFI should undertake and sets out options for the institutional form. A further Cabinet paper will seek decisions on detailed operational design.

### Executive Summary

2. In order to deliver the Budget Responsibility Rules and Policy Costing Unit manifesto commitments made by parties that now make up the Government, we propose establishing an IFI to undertake the following functions, consistent with the stated overarching purpose.

Purpose	
To enhance fiscal responsibility, accountability and transparency, promote better-informed public debate, and strengthen Parliamentary scrutiny.	
Fiscal council functions	Policy costing functions
<ul style="list-style-type: none"><li>• Assess compliance with the government's fiscal strategy.</li><li>• Comment on the Treasury's economic and fiscal forecasts.</li><li>• Comment on long-term fiscal sustainability and key fiscal risks.</li><li>• Produce research and information relating to its fiscal council functions.</li></ul>	<ul style="list-style-type: none"><li>• Provide financial costings of political party policies, including election manifestos and any costings requested during negotiations to form a government.</li><li>• Produce research and information relating to its policy costing function.</li></ul>

3. Our preference is to appoint a new Officer of Parliament to carry out the IFI's functions. We consider this appropriate given the functions are being established to provide a check on the Executive, and the need for a high level of independence in carrying out the functions. Bipartisan support is usually required to create a new Officer of Parliament.

4. We propose establishing the IFI from 1 July 2021, to allow sufficient time to pass legislation and set up the new body. As this date falls after the next general election, we also propose establishing an interim unit in the Treasury to undertake the policy costing function in the build-up to the election.

## **Background**

5. The establishment of an IFI would fulfil election commitments made by parties that now make up the Government in relation to the Budget Responsibility Rules and Policy Costing Unit.
6. Cabinet previously agreed to release a discussion document on proposals to establish an IFI, and invited the Minister of Finance to report back with final policy proposals [CBC-18-MIN-0084 refers].
7. Consultation on the discussion document closed on 24 October 2018. The majority of submitters supported the establishment of an IFI and its proposed functions. Submitters generally agreed it should be part of the legislative branch rather than the executive branch of government. Among those that offered a view, most favoured appointing a new Officer of Parliament to carry out the IFI's functions, to provide it with credibility and independence.

## **The Case for an IFI**

8. New Zealand has not experienced some of the issues that have resulted in the introduction of IFIs in other countries. The Treasury's forecasts are independent and do not tend to suffer from optimism bias. New Zealand's fiscal position is strong by international comparison, with no tendency to run frequent deficits. However, there are gaps in our fiscal framework that an IFI would help address:
  - Providing independent evaluation of fiscal policy performance
  - Enhancing parliamentary scrutiny over fiscal policy and public finances, and
  - Improving the process for costing political party policies.
9. Internationally, the academic literature suggests that IFIs help improve fiscal transparency and accountability, and improve the quality of public debate. An IFI would help Parliament hold the government to account for its performance. In Australia, a National Audit Office review found that by providing non-partisan access to policy costings, the Australian Parliamentary Budget Office (PBO) had made a significant contribution to levelling the playing field for parliamentarians and improved transparency around election commitments.

## Functions

10. Internationally, IFIs undertake a range of functions. The specific challenges and legal and institutional architecture in each country will determine what functions add most value. We propose that the New Zealand IFI undertake the following functions, consistent with the stated overarching purpose.

Purpose	
To enhance fiscal responsibility, accountability and transparency, promote better-informed public debate, and strengthen Parliamentary scrutiny.	
Fiscal council functions	Policy costing functions
<ul style="list-style-type: none"> <li>Assess compliance with the government's fiscal strategy.</li> <li>Comment on the Treasury's economic and fiscal forecasts.</li> <li>Comment on long-term fiscal sustainability and key fiscal risks.</li> <li>Produce research and information relating to its fiscal council functions.</li> </ul>	<ul style="list-style-type: none"> <li>Provide financial costings of political party policies, including election manifestos and any costings requested during negotiations to form a government.</li> <li>Produce research and information relating to its policy costing function.</li> </ul>

### ***Fiscal council functions***

11. The Public Finance Act 1989 (PFA) requires the Minister of Finance to present to Parliament a report on the government's fiscal strategy each financial year. The *Fiscal Strategy Report* must set out the government's fiscal strategy covering five fiscal aggregates (for example, debt and the operating balance) over both at least a 3-year horizon and a 10-year horizon, and provide a self-assessment of past and likely future performance against the government's fiscal strategy. There is no explicit requirement in the PFA that provides for an independent assessment. The Treasury's *Economic and Fiscal Update* documents are not required to provide this independent assessment.
12. To address this gap, we propose the IFI provide an assessment of the government's compliance with its fiscal strategy. The IFI would report to Parliament soon after the release of key documents, including the government's yearly *Budget Policy Statement* and *Fiscal Strategy Report*. It would also comment on the Treasury's economic and fiscal forecasts twice a year, and on the Treasury's *Long-term Fiscal Statements* and *Investment Statements*. The IFI's reports would be referred to the Finance and Expenditure Committee.
13. This function has been altered from that set out in the discussion document. The discussion document stated the IFI would "comment on and assess compliance with the government's fiscal strategy and fiscal targets", whereas we now propose it would "assess compliance with the government's fiscal strategy".
14. We no longer consider it is desirable to *require* the IFI to comment on a government's fiscal strategy. Doing so would risk undermining the bipartisan support and impartiality the IFI needs to deliver its other functions.

15. The IFI should provide parliamentary oversight of the Government's compliance with its fiscal strategy, but not seek to replace the Government's role as setting the fiscal strategy.
16. As an independent body, the IFI would have flexibility to determine how it performed its functions in support of its purpose statement. For example, in assessing compliance with this Government's long-term objective that "*the Government will reduce the level of net core Crown debt to 20 per cent of GDP within five years of taking office, and maintain it at prudent levels thereafter*", the IFI might present views on what "prudent" means. Under the function to "*comment on long-term fiscal sustainability and key fiscal risks*", the IFI might comment on how the Government's fiscal strategy contributes to long-term fiscal sustainability.

### ***Policy costing function***

17. Internationally, Australia, Canada, and the Netherlands have established IFIs that have a role in costing political party policies. No equivalent public institution exists in New Zealand. The public service costs government policies to inform policy advice and the fiscal forecasts, but does not cost the election policies of the governing parties. A protocol allows political parties to request the public service to cost their policies. However, previous governments have agreed to maintain a practice of not asking the public service to cost political party policies, in order not to damage the neutrality of the public service.
18. The IFI would produce an estimate of the fiscal cost of political party policies when requested to do so by the political party. This would show the profile of the cost of the policy over an agreed period e.g. 4 or 10 years. This would not include any commentary on the broader costs and benefits of the policy. Costings should include behavioural responses (e.g. reduced consumption of tobacco following an increase in tobacco excise), where necessary to produce an accurate costing and reflecting the IFI's best professional judgement. The IFI would provide an accompanying note detailing the costing, including any assumptions used.
19. To promote transparency, requirements would be established for the publication of costings. Details on the trigger for this and the frequency of publication are still being determined.
20. We propose that access to the costing service be provided to all political parties currently represented in Parliament and parties outside of Parliament that have received at least 3 per cent of the party vote in the preceding general election. Further consideration will be given to the circumstances under which emergent political parties have access to the costing service, e.g. newly registered political parties.
21. The IFI would need to establish an approach for rationing and prioritising costings, in agreement with political parties, should demand for the service exceed the available resources. For example, the Australian PBO prioritises requests based on a set of principles, including the level of representation the party has in Parliament and the extent to which the party has recently used the

PBO. The Canadian PBO allocates its resources equally between all political parties represented in Parliament.

### **Institutional Form**

22. For the IFI to perform its functions successfully, it will require a high degree of independence (both real and perceived) from the government-of-the-day to ensure political parties and the public have confidence in the impartiality of the IFI's work. We therefore propose the IFI be established in the legislative branch and be accountable to Members of Parliament, rather than in the executive branch and accountable to Ministers. Feedback on the discussion document overwhelmingly supported this approach.
23. We propose that one institution should undertake both the fiscal council functions and the policy costing function. The similarity of the skillsets required to perform the functions will allow for sharing of resources across both functions. This would in turn help with the practical consideration of staffing the IFI in a small country like New Zealand, and in managing peaks and troughs in the IFI's workload, for example in the run up to an election. There are also likely to be synergies between the functions, for example understanding the Treasury's forecasts could help the IFI undertake policy costings.
24. The Auditor-General has raised the possibility that commenting on forecasts that may contain policies that the IFI has previously costed could be a conflict of interest, and therefore recommends splitting the functions across two institutions. We do not consider this is a significant conflict. The public service would still produce costings of government policy, not the IFI, and these would be included in the Treasury's economic and fiscal forecasts. If the IFI thought that a specific policy included in Treasury forecasts warranted discussion, having produced an alternative costing would place the IFI in a good position to comment on the Treasury's forecasts.
25. There are several options for the precise institutional form the IFI could take. These options, and their implications, are set out below.

### ***New Officer of Parliament***

26. Our preferred option would be to appoint a new Officer of Parliament to carry out both the fiscal council and policy costing functions. Officers of Parliament are accountable to Parliament, and their funding is set by the Officers of Parliament Committee (OPC).
27. We consider the Office of Parliament model to be the best fit given the functions are being established to provide a check on the Executive, and due to the particularly high premium we place on independence in order for the IFI to be successful. It is fundamentally important that it be seen as impartial and serving all political parties fairly. Appointing the head of the IFI as an Officer of Parliament would also strengthen the mana of the role, ensuring the IFI has the best chance of attracting a high-quality leader.

28. A main disadvantage of this approach is that establishing a new Officer of Parliament is likely to be difficult. Standing Orders require the OPC to consider any proposals to create a new Officer of Parliament. OPC then makes its recommendation to Parliament. If Parliament reaches consensus on the creation and appointment of a new Officer, it makes its recommendation to the Governor-General.
29. Parliament has only rarely supported proposals to create new Officers. Since the last new Officer was established in 1986 (the Parliamentary Commissioner for the Environment), Parliament has rejected proposals to appoint the Children's Commissioner, the Retirement Commissioner, the Privacy Commissioner, and the Human Rights Commissioner as new Officers.

#### ***Office of the Clerk***

30. If it is not possible to establish a new Officer of Parliament, we consider the next best option is to establish the IFI functions within another part of the legislative branch. One option would be to establish them as part of the Office of the Clerk. The Clerk is accountable to the Speaker and the Office of the Clerk's funding is set by Cabinet.
31. The advantage of this model is that the Office of the Clerk is not accountable to Ministers and has an established reputation for providing trusted and independent advice to parliamentarians. We expect the Office of the Clerk would be able to draw on the existing expertise in the Parliamentary Library.
32. The main disadvantage of this model is that some of the IFI functions, in particular providing policy costings, would be a significant departure from the Office of the Clerk's existing functions to service Parliament, and could risk undermining the Clerk's relationships with parliamentarians. Statutory safeguards would be necessary, to help separate the IFI functions from the day-to-day functions of the Clerk, for example by establishing the head of the IFI as a separate role in the Office with distinct branding. The accountabilities of the head of the IFI and their relationship with the Clerk would need to be worked through. The Clerk of the House has indicated that his Office is open to undertaking the IFI functions, should that be the preferred option.
33. There is no precedent on the process for establishing the IFI's functions in the Office of the Clerk. However, it is likely the Speaker would want to consider whether there was bipartisan support within Parliament for the proposal, and, if so, would chair a cross-party committee to identify and appoint the head of the IFI.

#### ***New legislative branch department***

34. If there is concern about the risks to the Office of the Clerk, and that any statutory safeguards could not sufficiently mitigate these risks, consideration could be given to the establishment of a new legislative branch department. A new legislative branch department would be accountable to the Speaker, and its funding would be set by Cabinet.

35. The funding required for a new legislative branch department and the process to establish it would likely be quite similar to establishing the functions in the Office of the Clerk. The main benefits of a separate institution would be that the IFI would be separate and distinct from the Office of the Clerk, and the head of the IFI would not be accountable to the Clerk. However, this would be considered a significant reform to the institutional structure of Parliament.

#### ***Office of the Auditor-General and Office of the Clerk***

36. Alternatively, the IFI's functions could be split, with the Office of the Auditor-General (OAG) undertaking the fiscal council functions and the Office of the Clerk or a new legislative branch department undertaking the policy costing function.
37. As an Officer of Parliament, the OAG has the independence and institutional credibility necessary to undertake the fiscal council functions. The OAG has expressed interest in taking on the IFI's fiscal council functions, and considers it could do so under its current mandate. The Auditor-General would be accountable for the fiscal council functions, although a new business unit with separate branding in the OAG could be established.
38. The main disadvantage of this model is that it would not deliver the synergies from keeping the functions together. The OAG's mandate would not allow it to take on the policy costing function, and it believes that amending legislation allowing it to undertake this function would create a conflict of interest, given its existing role in providing assurance of the cost-effectiveness of policies.
39. The OAG plays a valuable role in supporting Parliament, in particular giving assurance that public entities are operating in line with Parliament's intentions. However, this is significantly different to the proposed fiscal council functions, which require economic and forecasting expertise to provide macroeconomic and fiscal analysis. Internationally, very few IFIs have been established in audit institutions.

#### ***Independent Crown Entity***

40. If the IFI did not sit within the legislative branch of government, it could be established in the executive branch as an Independent Crown Entity (ICE), like the New Zealand Productivity Commission and the Electoral Commission.
41. This model offers the highest level of independence of an executive agency, which could be further enhanced if the leadership of the IFI were appointed by resolution of the House. Internationally, many IFIs are part of the executive branch, even though they perform a role in holding the executive to account.
42. The main disadvantage of this model is that an ICE may be seen as less independent than a parliamentary institution. ICEs are accountable to a responsible Minister, and their funding is set by Cabinet.

## **Interim Arrangements**

43. We propose establishing the IFI from 1 July 2021, to allow sufficient time to pass legislation and set up the new body. As this date would fall after the next general election, we also propose establishing an interim unit in the Treasury to undertake the policy costing function in the build-up to the election.

### ***Functions***

44. As with the permanent IFI, the interim unit would only produce a policy costing where requested by a political party and would not comment on the broader costs and benefits of the policy. We propose that this service only be offered to parties that are currently represented in Parliament. In agreement with Cabinet, the interim unit would establish an approach for rationing provision of its costing service.

### ***Form***

45. Given the likely breadth and unpredictability of requests for costings, this will require establishing an interim unit that, at least in part, will commission information and costings from other public service agencies (in this regard, it is similar to the policy costing process during the government formation period). It may need to pull in additional resource if there are peaks in requests or for different types of request.
46. We consider that the Treasury is best placed to undertake this function as it has the analytical capability across a range of policies, is well-placed to coordinate requests across agencies, and can shift resources depending on demand for the service.
47. To help improve the independence of the interim arrangement, we propose the Minister of Finance write to the leaders of all parliamentary political parties and release a public statement clarifying that Ministers will not attempt to access any information relating to political party costings and directing Chief Executives to treat the information in the strictest confidence. Ensuring there is transparency around the proposed principles, procedures, and processes of the function may also go some way to making up for the lack of statutory independence.
48. Even so, producing policy costings in the lead-up to an election carries a high risk of undermining the perceived impartiality of the public service, especially in the absence of statutory independence to safeguard the political neutrality of the public service. If the costing methodology was disputed, or if an error was made, this could significantly affect the public service's reputation and relationships. The Treasury will investigate specific institutional form options that could help to provide some mitigation of this risk, for example by creating a departmental agency within the Treasury to undertake the function.
49. An alternative would be to establish the unit within the State Services Commission (SSC). An advantage of this is that the unit would benefit from association with the State Services Commissioner's existing roles to:

- Ensure state services maintain high standards of integrity and conduct and are led well and are trusted, and
- Act as the contact point and facilitator between political parties and state sector agencies during the post-election government formation period.

50. While we propose establishing the functions in the Legislature in the long-term, we do not propose establishing the interim policy costing unit in an existing parliamentary institution. No existing Officer of Parliament would be a good fit or be willing to undertake the policy costing function. Parliamentary Service (and the Parliamentary Library) are unable to undertake policy costings explicitly for electioneering purposes without legislative change. <sup>[36]</sup>

We consider that the Treasury would be better placed in the short-term to deliver this function for the 2020 election.

51. The interim unit would impose additional pressure on public service agencies, given the likely need for individual agencies to model the costings. This additional pressure may crowd out work on Government priorities.
52. Information held by the interim unit and other public service agencies would be within scope of the Official Information Act. However, the Ombudsman is of the view that information relating to the costing of political party policies could likely be withheld from release, on the grounds that release of information would prejudice the supply of similar information. However, the Ombudsman would need to assess any complaints on a case-by-case basis. The Chief Ombudsman has agreed to publish a statement of principle to this effect.

### **Consultation**

53. The Treasury, the Office of the Clerk, OAG and SSC were consulted in the preparation of this paper. DPMC were informed. Comments have only been included below where they disagree with the recommendations in this paper.

### ***Office of the Auditor-General***

54. The Auditor-General considers independence is crucial to the credibility of the IFI. In his view, an Officer of Parliament model is preferred because it is accountable to, and funded through, Parliament, as well as having other safeguards around independence.
55. The Auditor-General is concerned about the potential conflicts that may arise as a result of establishing a single institution with both policy costings and fiscal council functions. Developing policy costings and then reviewing forecasts that may contain policies that the IFI has costed, could undermine the credibility and independence of the institution. Managing this conflict would require a degree of internal separation between these functions, and this will limit any synergies gained by having both functions in a single institution.
56. The Auditor-General considers the fiscal council functions have a natural fit with his existing functions. The OAG already has relevant systems, processes and a strong, independent brand so it is likely that this would be a cost effective option. The Public Audit Act 2001 already allows the Auditor-General to undertake the functions of this type on a discretionary basis and these functions are well aligned to the strategic intentions of the Office. However, the Office will need additional resource to carry out these new functions.

57. The Auditor-General already makes a substantial contribution to the effectiveness of the fiscal framework by supporting Parliamentary scrutiny of entity and government financial performance and reviewing the Treasury’s *Long-term Fiscal Statement*. If an IFI is established, there is a risk that some activities could be duplicated and it will be important to ensure the mandate of the Auditor-General is not curtailed.

**State Service Commission**

58. The Minister of State Services has expressed concern about fragmentation in the State Services and considers that a strong case is required to justify the establishment of new entities.

59. SSC does not support the proposal to establish a new Officer of Parliament and does not agree that the proposed functions (fiscal council and policy costing) should be undertaken by the same institution.

60. SSC would support a proposal for the OAG to perform the fiscal council functions. In respect to the policy costing function, SSC acknowledges there is no natural fit for the function in the current state sector landscape, but thinks it is premature to seek agreement on the final form.

61. SSC has serious concerns about the proposed interim arrangements regarding the political neutrality of the public service. SSC’s view is that the interim policy costing function should not be established without the appropriate statutory independence to safeguard the political neutrality of the public service. If Ministers wish for this function to be delivered in the interim without statutory independence there are a range of options that could provide some mitigation for the risks (including options around institutional form for the unit). SSC believes further work needs to be undertaken to develop proposals for the interim function.

**Financial Implications**

62. The Budget 2019 package includes new funding in a tagged contingency for the interim policy costing unit. This funding will be drawn down once the detailed policy design has been considered by Cabinet.

<i>\$million</i>	Operating						Capital
	18/19	19/20	20/21	21/22	22/23	<i>Total</i>	
Interim policy costing unit	-	1.4	1.5	-	-	2.9	-

63. It is estimated that the following new operating funding and capital investment will be required from Budget 2020 to establish a new permanent institution:

<i>\$million</i>	Operating						Capital
	19/20	20/21	21/22	22/23	23/24	<i>Total</i>	
New permanent institution	-	0.9	6.6	6.5	7.0	21.0	2.5

64. This cost estimate does not include funding to support public service agencies experiencing additional resource pressures because of information requests from the IFI. We expect in most cases agencies should be able to absorb these pressures or, where they cannot, we would expect them to reprioritise or submit a capability Budget initiative.

**Human Rights, Gender and Disability implications**

65. The proposals in this paper have no implications for human rights, gender or disability.

**Legislative Implications**

66. If the IFI is established as a new Officer of Parliament or a new legislative branch department this will require new legislation, and may require an amendment to the Public Finance Act 1989. If the IFI is established in the Office of the Clerk, this may require legislation to amend the Clerk of the House of Representatives Act 1988.

67. Cabinet has agreed to put the legislation on the 2019 legislative programme [CAB-19-MIN-0049 refers].

**Regulatory Impact Analysis**

68. The Regulatory Quality Team has determined that a Regulatory Impact Assessment is not required because the proposed amendments have no or only minor impacts on businesses, individuals or not-for-profit entities.

**Publicity**

69. We do not propose to make any public statements on the IFI until further detailed policy design work has been undertaken and considered by Cabinet.

**Proactive Release**

70. We intend to delay the proactive release of this paper until detailed design decisions have been taken on the establishment of an IFI. As per Cabinet Office Circular CO (18) 4, proactive release may be delayed if the material is subject to an extended policy process where release of Cabinet material may be premature while advice remains under active consideration and further decisions are pending.

**Recommendations**

71. We recommend that the Committee:

**71.1 agree** to establish an independent fiscal institution (IFI) with the following purpose and functions:

Purpose	
To enhance fiscal responsibility, accountability and transparency, promote better-informed public debate, and strengthen Parliamentary scrutiny.	
Fiscal council functions	Policy costing functions
<ul style="list-style-type: none"> <li>Assess compliance with the government’s fiscal strategy.</li> <li>Comment on the Treasury’s economic and fiscal forecasts.</li> <li>Comment on long-term fiscal sustainability and key fiscal risks.</li> <li>Produce research and information relating to its fiscal council functions.</li> </ul>	<ul style="list-style-type: none"> <li>Provide financial costings of political party policies, including election manifestos and any costings requested during negotiations to form a government.</li> <li>Produce research and information relating to its policy costing function.</li> </ul>

**71.2 agree** that access to the IFI’s policy costings function should be provided to all political parties represented in Parliament and any registered political party not represented in Parliament that has received more than 3 per cent of the party vote in the preceding general election;

**71.3 agree** to pursue establishment of a new Officer of Parliament to undertake the functions of the IFI;

**71.4 invite** the Minister of Finance to consult the Speaker and Members of the Opposition on the establishment of an IFI;

**71.5 agree** to introduce legislation in late 2019 to establish the IFI, with a view to the IFI commencing operations from 1 July 2021;

**71.6 agree** to establish an interim policy costing unit within the Treasury to provide costings for the 2020 general election;

**71.7 invite** the Minister of Finance and Associate Minister of Finance (Hon James Shaw) to report back to Cabinet in July 2019 with detailed designs for the establishment of the permanent IFI, including:

- i. what threshold any emergent parties, e.g. newly registered political parties, will need to meet to have access to the policy costing service; and

- ii. options on when the policy costing service should be available (either throughout the parliamentary term or for a shorter period in advance of a general election); and

**71.8 invite** the Minister of Finance and Associate Minister of Finance (Hon James Shaw) to report back to Cabinet at a later date with detailed designs for the establishment of the interim arrangements, including options to help safeguard the political neutrality of the public service when undertaking the interim policy costing function in advance of the 2020 election.

Authorised for lodgement

Hon Grant Robertson  
Minister for Finance

Hon James Shaw  
Associate Minister of Finance