

The Treasury

Budget 2022 Information Release

August 2022

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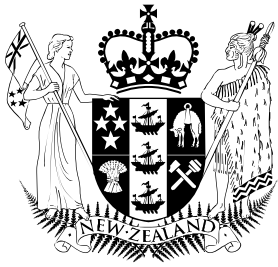
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Budget Ministers 5

Near-Final Budget 2022 Package

22 March 2022

Purpose

The key objective for this meeting is to seek your agreement to a near-final package for Budget 2022.

In our previous meetings we have taken decisions to shape a package that meets our priorities, addresses cost pressures, and fits within the Budget 2022 operating allowance of \$6 billion per annum.

However following decisions we took at Budget Ministers 4 and some further changes I have made, the draft package still exceeds the Budget 2022 operating allowance by ^[38]

In order to confirm a near-final package in this meeting, I would like to:

- **Confirm** an approach to manage to the \$6.0 billion operating allowance. I will bring a list of specific proposals to the meeting with respect to this.
- **Provide** you with the updated fiscal outlook
- **Agree** to a near-final Budget 2022 package to take to Cabinet, including finalising the Climate Emergency Response Fund, cost pressure, and manifesto sub-packages, and
- **Identify** any outstanding issues to be considered at Budget Ministers 6 on 1 April, ahead of Cabinet's agreement to the Budget 2022 package on 11 April.

Proposed approach to manage within allowances

I have made the following changes to the Budget 2022 package in order to get closer to the \$6 billion operating allowance.

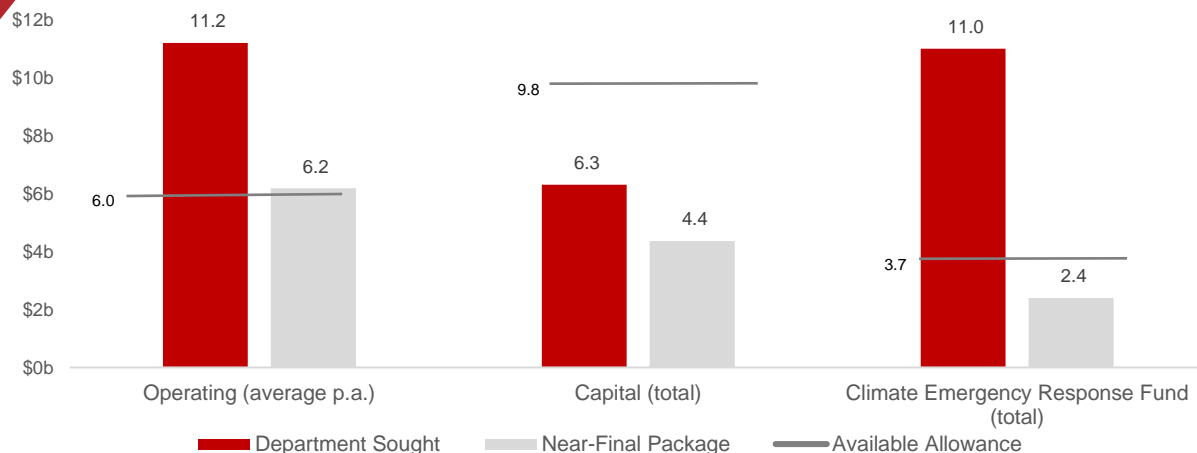
Item	Operating avg p.a.
Budget 2022 package following Budget Ministers 4	[38]
Funding New Zealand Defence Force depreciation from outside allowances	(\$112 million)
Rephasing the allowance impact of the Justice and Natural Resources clusters	(\$150 million)
Delay the start date of the Social Unemployment Insurance Scheme to 2025, with significant funding decision deferred to Budget 2023	(\$118 million)
Reprioritising funding held in tagged contingency	(\$4 million)
Managing Education forecast changes against allowances	(\$88 million)
Changes to cost pressures and manifesto commitments based on minimum viable options	(\$30 million)
Amended housing package	(\$62 million)
Updated total	[38]

These changes get us closer to the \$6 billion operating allowance. However, **the package will need to be reduced by a further** [38] As the package already reflects minimum viable options for cost pressures and manifesto commitments, it is likely any reduction will need to be found in the Health, Education or Welfare sub-packages.

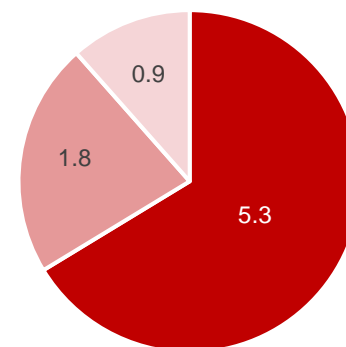
I am considering whether there are further opportunities to reprioritise more funding from tagged contingencies and unallocated funding from the COVID-19 Response and Recovery Fund.

Overview of near-final package

Budget 2022 & CERF - Department Sought vs Near-Final Package (\$b)



Total Operating Funding (Budgets 2022-2024) by Type (\$b)



■ Cost Pressures ■ New Spending ■ Pre-Commitments

	B22 opex (\$b p.a.)	B23 opex (\$b p.a.)	B24 opex (\$b p.a.)	Capex (\$b total)
Allowances	6.0	4.0	3.0	9.8
Pre-Commitments	[38]	-	-	0.57
Health cost pressures		1.31	-	1.31
Health New Spending		0.25	-	0.26
Education		-	-	[38]
Welfare		-	-	
Clusters		0.42	0.42	0.08
Cost Pressures		-	-	0.99
Manifesto Commitments		-	-	0.38
Savings		-	-	-
Total		1.98	0.42	4.36

Fiscal Outlook

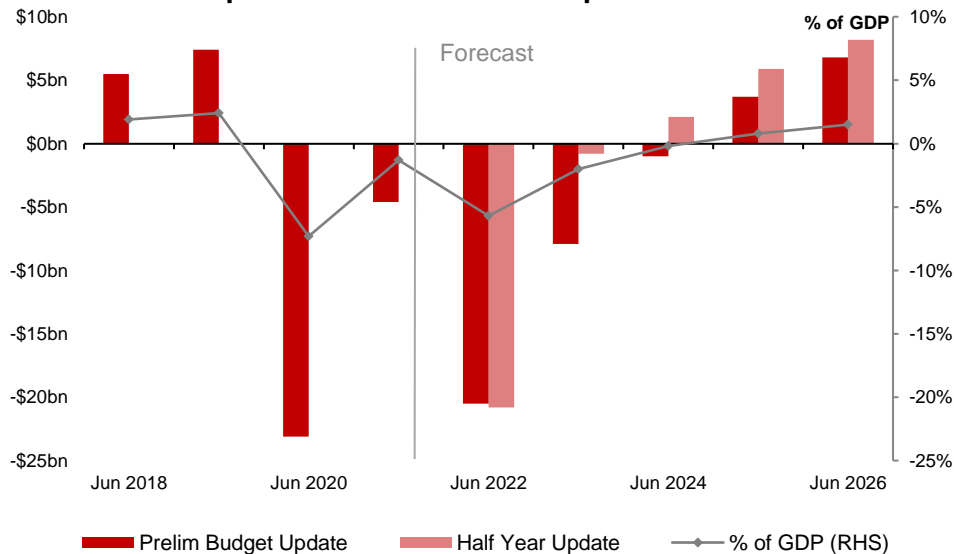


Fiscal Outlook

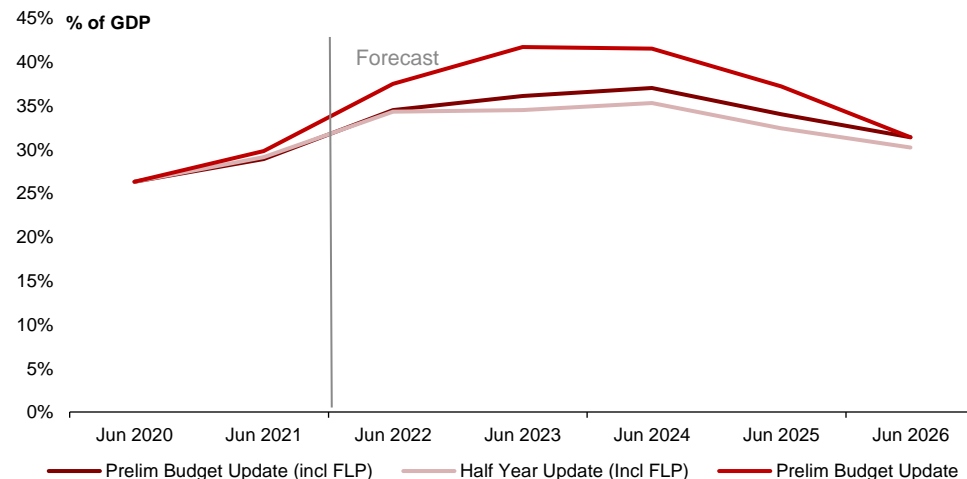
Preliminary fiscal forecasts show a weaker outlook compared to the Half Year Update with a delayed return to surplus and slighter higher debt track

- The operating balance before gains and losses (OBEGAL) deficit in the current year is expected to be \$20.5 billion which is broadly consistent with the forecast at the *Half Year Update*.
- However, beyond the current year the OBEGAL track is now expected to be weaker. Although updated economic conditions have led to an upward revision in tax revenue, this has been more than offset by revisions to expenses. In particular:
 - higher inflation, higher interest rates and stronger wage growth has resulted in higher costs over the forecast period, such as ACC claims costs, benefit payments and finance costs
 - the level of funding in the COVID-19 Response and Recovery Fund has increased, and
 - the expectation that more of the Climate Emergency Response Fund will fund operating expenditure have also impacted on OBEGAL.
- OBEGAL is forecast to return to surplus in 2024/25, which is one year later than expected at the *Half Year Update*. By the end of the forecast period the OBEGAL surplus reaches \$6.8 billion.
- Net core Crown debt (including Funding for Lending (FLP) assets) is forecast to be slightly higher across the forecast period compared to the *Half Year Update*. It is now forecast to peak as a percentage of GDP at 37.0% of GDP in 2023/24, before dropping to nearly 30% of GDP in 2025/26.
- We will discuss the Treasury's final economic forecasts for the *Budget Update* at our next meeting. Along with our decisions on the Budget package, these will then be incorporated into the final fiscal forecasts.

OBEGAL comparison to the Half Year Update



Net debt comparison to the Half Year Update



Near-Final Budget 2022 Package

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Overview of near-final package

- Budget 2022 will continue to make progress on our goals of 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 our climate change response, housing affordability and child poverty.
- We also identified two policy areas as a particular focus for Budget 2022: embedding the health reforms; and making progress towards our emissions reduction goals.
- This near-final package incorporates decisions taken at Budget Ministers 4 and the proposed approach to managing to the \$6 billion operating allowance for Budget 2022 outlined on slide 3.

Subject to further decisions, the near-final package amounts to:

[38]	\$1.98b per annum operating funding (B23 allowance)	\$0.42b per annum operating funding (B24 allowance)	\$4.4b total capital funding	\$2.4b from the Climate Emergency Response Fund (CERF)
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Key investments include:

<p><u>Key policy goals</u></p> <ul style="list-style-type: none"> • \$13.2b operating to cover two budgets of spending for the Health system, incl \$2.0b new spending and \$11.2b for rebase/cost pressures • \$2.4b total for climate response measures from CERF 	<p><u>Other significant areas of investment</u></p> <ul style="list-style-type: none"> • \$2.0b operating for Education cost pressures and new spending • \$1.8b operating for Welfare cost pressures and new spending
<p><u>Pilots of multi-year cluster model</u></p> <ul style="list-style-type: none"> • \$2.7b for the Justice sector • \$1.0b for Natural Resources 	<p><u>Investment in priority communities</u></p> <ul style="list-style-type: none"> • \$780m for initiatives directly impacting Māori • \$161m for initiatives directly impacting Pacific peoples

Key policy area – Health

- Embedding health reforms is a key focus for Budget 2022. We will do this by building on initial investment in Budget 2021, establishing new entities on a sustainable footing and making early progress on system reform. We will also begin the transition to multi-year funding.
- Investment will be across two sub-packages – new spending to support key reform shifts and deliver on our other key priorities; and investment to rebase the health system and meet forecast pressures.
- As agreed at BM4, I am proposing a \$2.0 billion total sub-package for new operating spending, split across Budget 2022 and 2023 allowances, along with \$1.6 billion total capital across cost pressures and new spending.
- I am proposing a package of \$1.8 billion per annum for the rebase and Vote Health cost pressures, [33]

Health new spending highlights

Key Initiative / Policy Area	Operating (total) (\$m)	Capital (\$m)
Hauora Māori commissioning	168	-
Primary care teams	102	-
Data & digital	220	100
PHARMAC	191	-
Specialist mental health and addiction services	100	-
Other	1,241	161
Total	2,022	261

Cost pressures and rebase

Key Initiative / Policy Area	Operating (B22) (\$m)	Operating (B23) (\$m)	Capital (\$m)
DHB deficits rebase	[33]	-	-
Vote Health cost pressures	4,828	3,925	-
Capital for sector infrastructure	-	-	1,307
Other	45	-	-
Total	[33]	3,925	1,307
Capital required to establish the balance sheet for Health New Zealand	-	-	1,000

Key decision: would you prefer to –

take these near-final Health sub-packages to Cabinet

consider further changes to the sub-packages ahead of Budget Ministers 6

Key policy area – Climate

- The Climate Emergency Response Fund (CERF), beginning at Budget 2022, is designed to cover multiple years and enable long-term investments. The CERF currently has \$3.7 billion available for the period between 2022/23 to 2025/26.
- The near-final CERF package amounts to **\$2.4 billion (operating and capital)**, leaving \$1.3 billion remaining in the CERF. It focuses on meeting our first emissions budget, critical Emissions Reduction Plan initiatives, and foundational investments for future emissions budgets.
- The CERF package has been iterated from the Climate Chief Executives' package, following decisions made at Budget Ministers 4.
- At this meeting, I recommend we focus on Transport in light of our recent announcement around cutting public transport fares in half for three months to provide cheaper transport options in the face of the global energy crisis.

Flagship CERF initiatives

Key initiative	Opex (\$m)	Capex (\$m)
Agriculture emissions reduction – Accelerating development of greenhouse gas mitigations	339	-
Funding further decarbonisation of industry and heat and implementing supporting policies (GIDI)	678	-
Delivering mode-shift and reducing VKT in New Zealand's main urban areas	375	-
Other	791	192
Total	2,184	192

Changes since BM4

- *Reducing emissions from waste* [33] (\$105m)
- *Accelerate the Decarbonisation of the Public Transport Bus Fleet* (included for a scaled amount of \$41m). This initiative was not included in the original draft package.
- *Delivering mode-shift and reducing VKT in New Zealand's main urban areas* [33]
- *Agriculture - Supporting producers and Māori entities transition to a low emissions future* [33] (\$35m).

Key policy area – Climate

Three choices remain following discussion at BM4, which I seek decisions on in this meeting.

Vehicle scrappage scheme

There are three options available for funding this initiative. Please indicate which option you wish to progress.

- Trial option only (\$32 million total operating) – *Treasury recommended*. This option would see 2,500 cars being scrapped over 2022/23 and 2023/24.
- Ministry of Transport proposed trial option (\$293 million total operating). This would involve a smaller trial (only 1,300 cars scrapped over 2022/23 and 2023/24), followed by a targeted roll out to key urban centres. This would lead to 22,500 cars being scrapped over 2024/25 and 2025/26.
- Roll out the scheme in full (\$578 million total operating)

Decarbonising buses

There are two options available for funding this initiative. Please indicate which option you wish to progress.

- Replace all buses with contracts coming up over the next three years (\$41 million total operating) – *Treasury recommended*.
- [33]

Making public transport more affordable for low income New Zealanders

There are two options available for funding this initiative. Please indicate which option you wish to progress.

- Fully fund the initiative, rolling out the fare subsidisation scheme nationwide (\$62 million total operating, \$2 million capital)
- Do not fund – *Treasury recommended*

- Funding **all of these changes in full** increases the cost of the package from \$2.4 billion to **\$2.8 billion**
- Funding the **medium scrappage option** (MoT trial), along with other changes in full, would cost **\$2.6 billion**
- I am discussing potential adjustments to the CERF package to include greater spending on Transport initiatives (in the order of \$200 million) with Ministers Shaw and Wood and will update you on their views at the meeting.

Do you agree to take this Climate response package to Cabinet (subject to decisions on individual initiatives above)?

Agree

Disagree

Investment in Education

- Through Budget 2022, we are aiming to provide strong support to education providers to maintain services to learners through the current pandemic and changing education environment. Difficult trade-offs have been made to ensure that we meet unavoidable cost pressures while also making meaningful progress towards our key Manifesto commitments.
- **I am proposing we agree a \$2.0 billion Education package, reflecting a revised package proposed by the Minister of Education following BM4.**
- This package focuses on supporting providers to meet rising costs and on delivering Manifesto commitments. It leaves out significant investments in learning support, system change and digital projects.
- In order to fit within a \$2.0 billion envelope, scaling or phasing decisions were taken that will decrease the impact on Budget 2022 allowances but will increase pressure on subsequent Budgets. [33]

Education investment highlights

Initiative	Operating Total (\$m)	Capital Total (\$m)	Overview of changes since BM4
2.8% cost adjustments for early learning, school and tertiary funding rates	695	-	- Scaled Pay Parity in Early Learning [38]
Continuing Tomorrow's Schools Reforms	62	-	- Cost adjustments scaled from [33] to 2.8% (-\$22 million)
Equity Index	294	5	- Scaled tertiary demand due to updated forecasts (-\$49 million)
Pay Parity for early learning teachers	[38]	5	- I am also considering whether to re-include the Māori Medium Property initiative (\$35 million operating, \$191 million capital)
Further Investment in School Property Portfolio	75	672	
Other initiatives	527	66	
Total	[38]	748	
One Year Extension of Apprenticeship Boost Initiative (ABI) – <i>Funded from CRRF and underspends expected from an existing pre-commitment.</i>	300	-	

Key decision: would you prefer to –

take this near-final Education sub-package to Cabinet

consider further reductions to the sub-package ahead of Budget Ministers 6

Investment in Welfare

- In Budget 2022, our areas of focus for welfare are continuing the Disability System Transformation, addressing cost pressures for Disability Support Services (DSS) and progressing key manifesto commitments including initiatives that are part of the Welfare Overhaul.
- **To achieve these objectives, I am proposing we support a Welfare package totalling ^[33] operating and capital funding.**
- As a result of scaling decisions, sizeable funding requests are expected through Budget 2023 and future Budgets including approximately \$700 million for DSS and the remaining funding required for a full national rollout of the Enabling Good Lives (EGL) approach to DSS. Furthermore, some initiatives are funded on a time-limited basis meaning decisions will be required to either stop them or provide them with more funding as part of a future Budget.

Welfare investment highlights

Initiative	Opex total (\$m)	Capex (\$m)
Cost Pressures for Disability Support Services	[33]	
National implementation of EGL approach		
New Ministry for Disabled People		
Child Support Pass-On		
Improving support for dental treatment for low-income New Zealanders	126	-
Social Sector Commissioning initiatives	[33]	
Other		
Total		

Overview of changes since BM4

- Added Dental initiative (+\$126m)
- [33]
-
-

Key decision: would you prefer to –

take this near-final Welfare sub-package to Cabinet

consider further reductions to the sub-package ahead of Budget Ministers 6

Clusters

- On 10 March, the clusters provided me with final Budget packages covering the next three years.
 - The Justice Cluster package is within the envelope amount we agreed at Budget Ministers 3 ^[38] and **I recommend we take this to Cabinet for approval.**
 - The Natural Resources Cluster package is close to the envelope we agreed at Budget Ministers 3 (\$1,040 million) with the removal of ^[33] **I am working with the relevant Ministers on closing the remaining gap**, and we will approve a final package at Budget Ministers 6.
- Both packages provide new funding to deliver against cluster and Government priorities while still addressing cost pressures and working within our fiscal constraints.

Justice Cluster

This package is focused on addressing critical cost pressures across the Justice system and improving system performance.

Cluster package highlights (\$m)	Total opex	Total capex
Strengthening legal aid to improve access to justice and reduce debt for low-income New Zealanders	161	-
Improving Police and Corrections frontline safety	319	27
Transforming court and justice services (Te Ao Mārama, and Sector-wide strategy and operating model to deliver better outcomes for victims)	70	-
Other priority initiatives and critical cost pressures	[33]	44
Total		69

Natural Resources Cluster

This package supports our major work programmes that are underway to deal with complex challenges, while continuing to deliver on core stewardship roles and responsibilities.

Cluster package highlights (\$m)	Total opex	Total capex
Implementing the Aotearoa New Zealand Biodiversity Strategy 2020	92	2
Implementing Resource Management Reform	148	-
Delivering integrated advisory services to support more sustainable and productive land-use practices	[33]	5
Other priority initiatives and critical cost pressures	678	5
Total*	[33]	12

* These numbers assume the Natural Resources Cluster package fits within the envelope.

Do you agree to take the Justice package to Cabinet and make final decisions on the Natural Resources package at BM6?

Agree

Disagree

Cost pressures

- Although we have made significant progress addressing cost pressures in key public services through recent Budgets, there is still more to do. As in previous years, cost pressures make up a substantial proportion of the Budget 2022 package.
- This package provides the minimum viable funding allocation required to meet these pressures without creating service delivery risks or future cost pressures; as such I am not proposing further scaling or deferral of these initiatives.
- Outside of the key sub-packages outlined previously, significant cost pressures can be found across a number of portfolios.

Votes with significant cost pressures	Opex total (\$m)	Capex total (\$m)
Housing and Urban Development & Building and Construction <i>Including for public and transitional housing and contracted emergency housing in Rotorua</i>	1,428	2
Transport <i>Including funding for the Civil Aviation Authority [37], [38]</i>	190	[37], [38]
Arts, Culture and Heritage <i>Including funding for replacing Te Papa's spirit collection facility</i>	[37], [38]	
Internal Affairs <i>Including modernisation the digital identity system and continued issuance of passports</i>	93	163
Revenue <i>Including funding to retain FTE required to continue delivery of IRD's COVID-19 response</i>	212	1
Other	1,216	279
Total	[37], [38]	

Overview of key changes since BM4

- \$450m total operating funding sought to meet a *depreciation funding shortfall* for the New Zealand Defence Force will now be met from outside allowances.
- [33]
 - and inclusion of \$221m for *non-recyclable funding for affordable rentals*.
- *Modernising and enabling digital identity services* scaled by \$32m operating and \$8m capital.
- *Responding to COVID-19 demand (Revenue)* scaled by \$22m operating.

Do you agree to take this cost pressure package to Cabinet?

Agree

Disagree

Manifesto initiatives

- Alongside the other sub-packages outlined previously, we have made a number of policy commitments that will support improved wellbeing outcomes for New Zealanders and it is important that we continue to deliver on these through Budget 2023.
- The sub-package of other manifesto initiatives I am recommending represents what I consider to be a minimum viable option for progressing commitments that cannot wait until Budget 2023. As such, I am not proposing further scaling or deferral of these initiatives.

Votes with significant manifesto initiatives	Opex total (\$m)	Capex total (\$m)
Transport <i>Including funding for Auckland Light Rail and Future of Rail projects</i>	548	[38]
Labour Market <i>Including funding for the establishment of a social insurance scheme starting [33]</i>	80	2
Housing and Urban Development & Building and Construction <i>Including funding for affordable rentals, the emergency housing system and Homelessness Action Plan</i>	468	-
Justice <i>Including funding for Preventing Family Violence and Sexual Violence initiatives and digitisation of the court system (Caseflow)</i>	[37], [38]	
Business, Science and Innovation <i>Including funding for the Regional Strategic Partnership Fund and implementing Industry Transformation Plans</i>	209	57
Other	737	(292)
Total	[37], [38]	

Overview of changes since BM4

- [33]

-

Do you agree to take this manifesto package to Cabinet?

Agree

Disagree

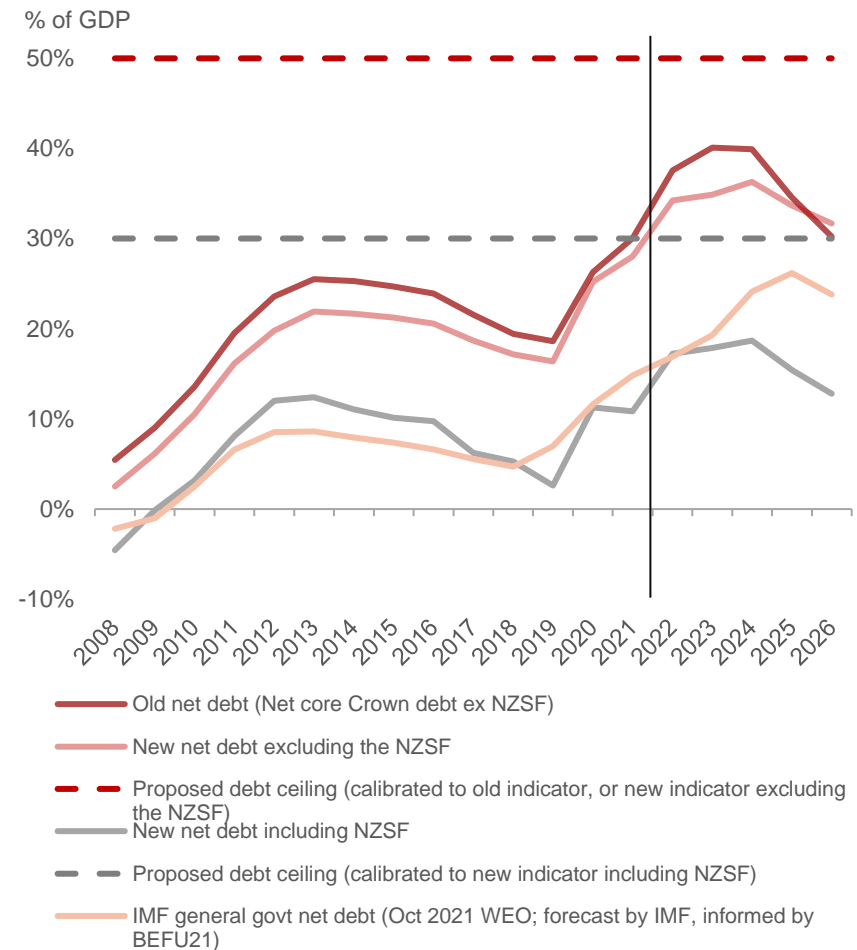
Moving towards new fiscal rules (for decision at Budget Ministers 6)

As New Zealand is moving past the immediate COVID-19 response phase and towards recovery, it is now the **right time to recalibrate our fiscal rules**.

- I propose **focusing on the operating balance before gains and losses (OBEGAL) as the main fiscal rule**. This supports intergenerational equity and is likely to result in a fiscally sustainable position. The OBEGAL target should be calibrated so that over time operating expenses do not add to net debt as a share of GDP.
- I propose that the OBEGAL rule is complemented with **a ceiling on net debt of 30% of GDP (based on the new net debt measure including the NZSF)**. This corresponds to a debt ceiling of 50% of GDP based on the old net debt measure excluding the NZSF.
- The ceiling is **not a point target** that we would aim for, but rather the level that we will aim to keep debt below. This debt ceiling would allow us to borrow for long-term investments where the cost can be spread across generations.
- I am looking at options to **strengthen our value-for-money tools** to ensure we're only funded good quality investments, which will enhance living standards.

I am receiving further advice on the wording and communication of the new fiscal rules for Budget 2022 in the coming weeks and propose that we discuss these at **Budget Ministers 6**.

Net debt indicators and corresponding debt ceiling (HYEFU 2021 data and forecasts)



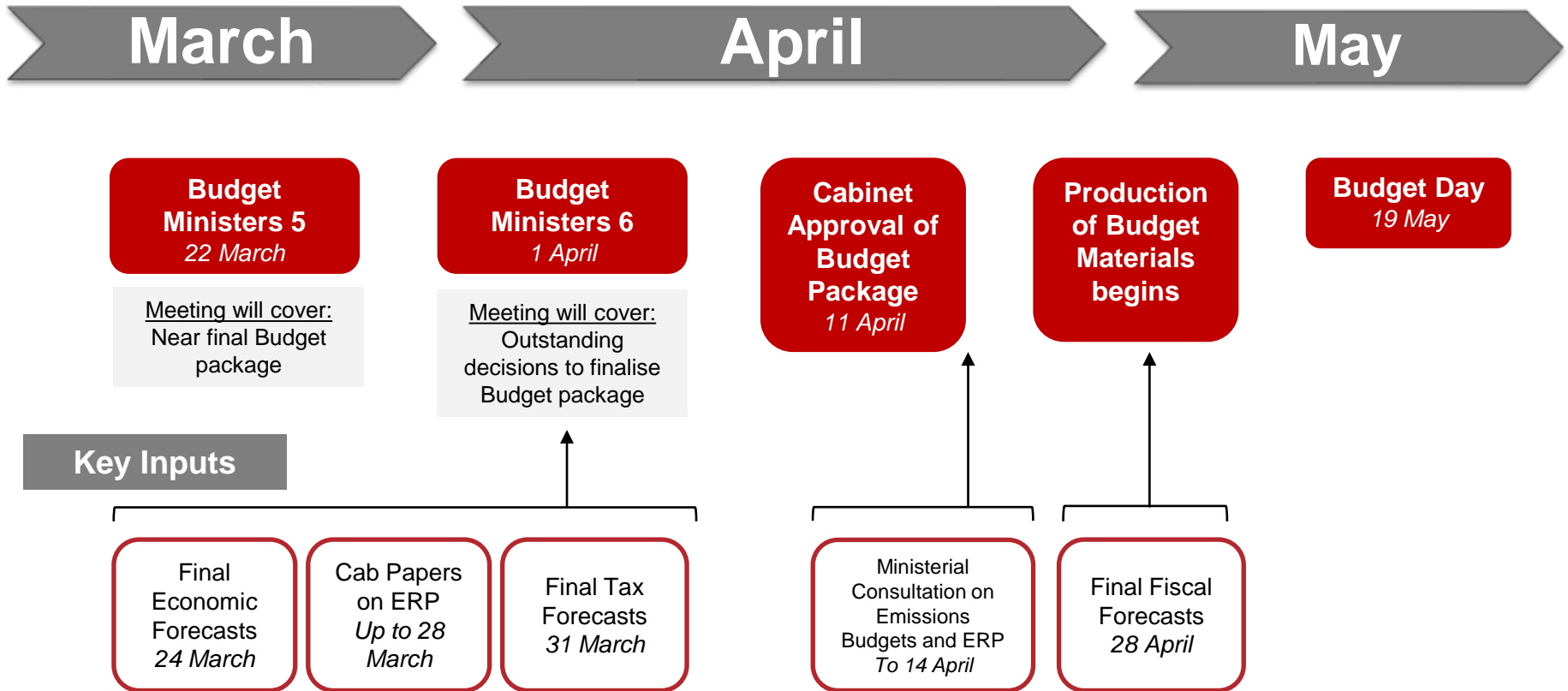
Outstanding decisions for BM6

Following this meeting, Treasury will communicate decisions on the sub-packages that we have agreed to agencies so they can develop financial recommendations.

Our final Budget Ministers meeting to confirm the Budget package will require our decision on the following items:

- Confirm the final health, education, and welfare sub-packages (subject to our decisions today on possible further reductions in these areas)
- Confirm any outstanding decisions on the transport components of the CERF
- Confirm the composition of the Natural Resources Cluster
- Further discuss and agree the new fiscal rules and confirm future allowances.

Timeline



Following this meeting, I propose to finalise the Budget package and present you with any outstanding decisions at our **next meeting on Friday 1 April**.