

# The Treasury

## Budget 2022 Information Release

August 2022

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# **Budget Ministers 6**

## **Final Budget 2022 Package**

**1 April 2022**

# Purpose

**The purpose of this meeting is to seek your agreement to the 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.

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

- **Note** the updated economic outlook,
- **Agree** to a final Budget 2022 package to take to Cabinet, and
- **Note** that I intend to seek Cabinet's agreement to close the COVID-19 Response and Recovery Fund on 11 April 2022.

I would also like to **recalibrate our fiscal rules** and discuss how we communicate these rules to New Zealanders.

# Economic Outlook

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# Economic Outlook

**While the NZ economy remains resilient** considering the impact of the COVID-19, the Omicron variant will nevertheless dampen growth over the first half of 2022. High inflation, skills shortages, and supply disruptions are weighing on confidence, although export prices remain high, demand for exports is solid, and the opening of the border is expected to ease labour market constraints and boost tourist sector incomes in time.

**The Ukraine crisis adds uncertainty to the outlook.** For New Zealand, the major economic impacts of the conflict are being felt through commodity prices. **Higher petrol prices are adding to inflation.** The reductions to excise taxes and public transport costs provide some relief, but this will eventually unwind.

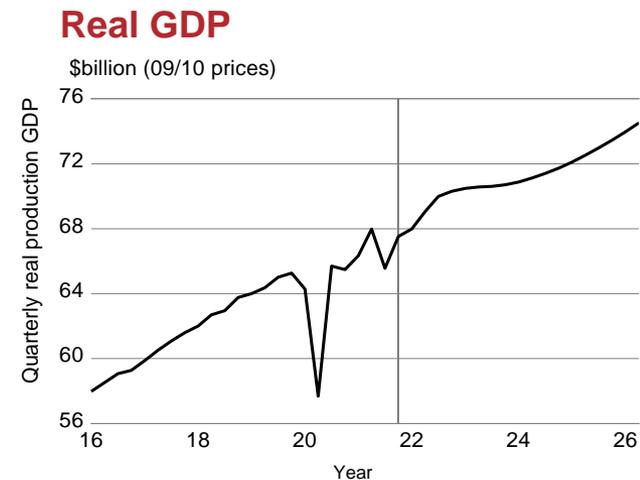
**The labour market is exceptionally tight and will remain so in the near term** as labour supply is constrained by Omicron. Wage pressure is building, although the reopening of the border sees some easing in labour constraints.

**The tight labour market, persistence in global supply disruptions, and resilient domestic demand mean inflation is persistent,** with interest rates increasing. Forecasts predict downward pressure on house prices, dampened demand and unemployment rising to a peak of 4.8% in 2025.

**Real economic activity remains broadly similar to the preliminary forecasts** but is expected to be more cyclical. Relatively robust near-term activity is expected to give way to a softer outlook reflecting higher interest rates and the unwinding of COVID-19-related government spending. Together with increased inflation and wage pressures, this will likely result in a decline in real government consumption.

**Higher inflation is expected to boost nominal GDP** by a cumulative \$26 billion relative to the preliminary forecasts and will boost tax forecasts being prepared.

**An earlier reopening of the border through 2022 will gradually boost migrant and tourist flows.** Prices for New Zealand's goods exports and imports are expected to remain high with robust global demand and ongoing supply constraints.



# Final Budget 2022 Package

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# Headline Figures: Budget Allowances

The following table includes spending from the \$6 billion allocated to Budget 2022 as well as some funding from Budget 2023 and Budget 2024 allowances.

	B22 opex (\$b p.a.)	B23 opex (\$b p.a.)	B24 opex (\$b p.a.)	Capex (\$b total)
<b>Allowances</b>	<b>6.0</b>	<b>4.0</b>	<b>3.0</b>	<b>9.8</b>
Pre-Commitments	[38]	-	-	0.65
Health Cost Pressures		1.31	-	1.31
Health New Spending		0.25	-	0.26
Education		-	-	0.86
Welfare*		-	-	-
Clusters		0.42	0.42	0.08
Cost Pressures		-	-	1.32
Manifesto Commitments		-	-	0.48
Savings		-	-	(0.03)
SaaS Adjustment		-	-	-
CRRF Reprioritisation		-	-	-
<b>Total net expenditure</b>		<b>1.98</b>	<b>0.42</b>	<b>4.92</b>

\*Excludes the *Child Support Pass-On* initiative which has been agreed as a pre-commitment and reflected in the pre-commitment line.

Note that for multi-year funding for health and clusters, we will expect agencies to operate within envelopes and therefore not seek new funding in 2023.

# 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 reforms and deliver on our other priorities; and investment to rebase the health system and meet forecast pressures.
- As agreed at Budget Ministers 4, I am proposing a \$2 billion total sub-package for new operating spending, split across Budget 2022 and 2023 allowances, along with \$1.6 billion total Budget 2022 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, including \$500 million per annum initially put in contingency to drive the strategic allocation of Health NZ's internal budget. [33]
- There have been no further changes to the Health package since Budget Ministers 5.

## 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
<b>Total</b>	<b>2,022</b>	<b>261</b>

## 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
<b>Total</b>	<b>[33]</b>	<b>3,939</b>	<b>1,307</b>
Capital required to establish the balance sheet for Health New Zealand	-	-	1,000

\*NB: We expect that these will be presented as a single combined baseline uplift in Budget documents

Do you agree to take the Health package to Cabinet?

Agree

Disagree

# Clusters

- Following Budget Ministers 5, the Justice Cluster package now includes additional funding for:
  - The two priority Police initiatives (*Police frontline safety* and *Preventing the harm from serious and organised crime*), and two priority initiatives for the Cluster focused on sector transformation (*Sector-wide strategy and operating model to support better outcomes for Victims*, and the *High impact innovation programme*).
  - To keep within the \$2.73 billion envelope, [38]
- I recommend we take this package to Cabinet for approval.**
- The Natural Resources Cluster package is now within the envelope we agreed at Budget Ministers 3 (\$1.04 billion) following the removal of the [33] **I recommend we take this package to Cabinet for approval.**

## Justice Cluster

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

Justice cluster package highlights (\$m)	Total opex (\$m)	Total capex (\$m)
Strengthening legal aid to improve access to justice and reduce debt for low-income New Zealanders	149	-
Improving Police and Corrections frontline safety	363	27
Transforming court and justice services (Te Ao Mārama, and Sector-wide strategy and operating model to deliver better outcomes for victims)	93	-
Other priority initiatives and critical cost pressures	2,125	38
<b>Total</b>	<b>2,730</b>	<b>65</b>

## 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.

Natural Resources cluster package highlights (\$m)	Total opex (\$m)	Total capex (\$m)
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	118	5
Other priority initiatives and critical cost pressures	682	5
<b>Total</b>	<b>1,040</b>	<b>12</b>

Do you agree to take the Natural Resources and Justice clusters' packages to Cabinet?

Agree

Disagree

# Climate

- The near-final Climate Emergency Response Fund (CERF) package is currently **\$2.4 billion (operating and capital)**, leaving \$1.26 billion remaining in the CERF. This figure includes changes I have made since BM4 including moving a Climate Change Commission cost pressure initiative into the CERF and funding the Circular Economy and Energy strategies.
- The Prime Minister and I have met with Ministers Shaw and Wood to discuss the bundle of Transport initiatives in the table below. There are also two alternative scaled options highlighted in **green** which would lead to a lower final CERF package.
- After BM4, Treasury estimated there would remain a **0.825MT gap** between the emissions reductions supported by this CERF package and the first emissions budget. They estimate that adding the \$554.74m Transport bundle (high option) below would decrease the gap to **0.802MT**.
- Forecast ETS proceeds have increased by ~\$750 million since the Half Year Economic and Fiscal Update as ETS prices are now at ~\$76. I propose that we top up the CERF with these proceeds, subject to confirmation in the final Budget Economic and Fiscal Update forecasts.

Initiatives	Treasury comment	High option	Low option
Assisting low-income New Zealanders to shift to cleaner vehicles (Vehicle scrappage component)	Interest was indicated at BM5 for the medium option targeting key urban centres. If desired, this could be kept at a basic trial at the Treasury recommended level of \$32 million (currently included in package numbers).	Fund at \$293m <b>(\$261m)</b>	Fund at \$253m <b>(\$221m)</b>
Accelerating the decarbonisation of the public transport bus fleet	This was added to the CERF package after BM4 at the Treasury recommended level of \$41 million. [33]	Keep at \$41m <b>(\$0)</b>	Keep at \$41m <b>(\$0)</b>
Making public transport more affordable for low- income New Zealanders	Costs revised to include an additional 2-3 months of the public transport subsidy to bridge the gap to the Community Connect scheme.	[33]	
Building a sustainable skilled workforce to support upscaling of bus networks	This would raise bus driver pay to \$26.00 an hour. [33]	Fund at \$61m <b>(\$61m)</b>	Fund at \$61m <b>(\$61m)</b>
Crown Support for Reduced Public Transport Revenue due to COVID-19	Interest was indicated to bring this into the CERF from the main Budget process.	Fund at \$47m <b>(\$47m)</b>	Fund at \$47m <b>(\$47m)</b>
[33]			

Final CERF package (high option)	<b>OPEX</b>	\$2747.85m	<b>CAPEX</b>	\$198.22m	<b>Total</b>	\$2946.06m
Final CERF package (low option)	<b>OPEX</b>	\$2687.85m	<b>CAPEX</b>	\$198.22m	<b>Total</b>	\$2886.06m

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

Agree

Disagree

# 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 propose we support a Welfare package totalling \$1.52 billion operating 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 future Budgets.
- There have been no further changes to the Welfare package since Budget Ministers 5.

## Welfare investment highlights

Initiative	Opex total (\$m)	Capex (\$m)
Cost Pressures for Disability Support Services	735	-
National implementation of EGL approach	100	-
New Ministry for Disabled People	108	-
Improving support for dental treatment for low-income New Zealanders	126	-
Social Sector Commissioning initiatives	50	-
Other	397	1
<b>Total</b>	<b>1,516</b>	<b>1</b>
Child Support Pass-On (note this has been pre-committed by Cabinet)	334	20

Do you agree to take the Welfare package to Cabinet?

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. Trade-offs have been made to ensure that we meet unavoidable cost pressures while also making significant, targeted investments and meaningful progress towards our key manifesto commitments.
- I propose we agree to the revised \$2 billion Education package** proposed by the Minister of Education following Budget Ministers 5. **and \$0.5 billion from outside Budget allowances** for Apprentice Boost Initiative and depreciation. <sup>[38]</sup>
- This package focuses on making targeted investments that will have the greatest positive impact. The majority of our investment in education will go directly to education providers, improving conditions for students, teachers and their communities.
- In order to fit within a \$2 billion envelope, scaling or phasing decisions were taken that will decrease the impact on Budget 2022 allowances but will increase pressure on subsequent Budgets. <sup>[33]</sup>

## Education investment highlights

Initiative	Operating Total (\$m)	Capital Total (\$m)
2.75% cost adjustments for early learning, school and tertiary funding rates	683	-
Continuing Tomorrow's Schools Reforms	62	-
Equity Index (including large increase to school equity funding)	292	8
Pay Parity for early learning teachers	<sup>[38]</sup>	5
Māori Education (including Māori-medium Property)	168	106
Further Investment in school property portfolio	81	672
Other initiatives	371	64
<b>Total Education package</b>	<sup>[38]</sup>	<b>855</b>
One-year Extension of Apprenticeship Boost Initiative (ABI) – <i>funded from CRRF and underspends expected from an existing pre-commitment.</i>	300	-
Uplift in school-property depreciation funding – <i>charged to the operating balance</i>	199	-

### Overview of changes since BM5

- Scaled Pay Parity in Early Learning <sup>[38]</sup>
- Cost adjustments scaled from 2.8% to 2.75% (-\$13 million)
- Māori-medium Property added (+\$20 million operating, +\$105 million capital)
- Added increase in school-property depreciation funding (+\$199m operating in 2025/26 & Outyears charged to the operating balance)

Do you agree to take the Education package to Cabinet?

Agree

Disagree

# Manifesto Initiatives

- 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, so I am not proposing further scaling or deferral of these initiatives. However, I do propose the three further changes to the Budget package below.
- The Budget package includes \$5 million charged against the Emerging Priorities Contingency (EPC) for COVID-19 Service Recognition and a \$20 million increase to the EPC balance.

Votes with significant manifesto initiatives	Opex total (\$m)	Capex total (\$m)
<b>Transport</b> <i>Including funding for Auckland Light Rail and Future of Rail projects</i>	548	[37], [38]
<b>Labour Market</b> <i>Including funding for the establishment of a social insurance scheme starting [33]</i>	73	2
<b>Housing and Urban Development &amp; Building and Construction</b> <i>Including funding for affordable rentals, the emergency housing system and Homelessness Action Plan</i>	468	-
<b>Justice</b> <i>Including funding for Preventing Family Violence and Sexual Violence initiatives and digitisation of the court system (Caseflow)</i>	[33], [38]	
<b>Business, Science and Innovation</b> <i>Including funding for the Regional Strategic Partnership Fund and implementing Industry Transformation Plans</i>	212	157
Other	758	(292)*
<b>Total</b>	[33], [37], [38]	

\*This figure is negative as it reflects a \$306.1 million savings in capital expenditure from the Manatū Taonga strong public media initiative

Do you agree to take this manifesto package to Cabinet?

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)
<b>Housing and Urban Development &amp; Building and Construction</b> <i>Including funding for public and transitional housing and contracted emergency housing in Rotorua</i>	1,566	1
<b>Transport</b> <i>Including funding for the Civil Aviation Authority and timely delivery of the City Rail Link</i>	155	372
<b>Arts, Culture and Heritage</b> <i>Including funding for replacing Te Papa's spirit collection facility</i>	138	171
<b>Internal Affairs</b> <i>Including modernisation of the digital identity system and continued issuance of passports</i>	93	163
<b>Revenue</b> <i>Including funding to retain FTE required to continue delivery of IRD's COVID-19 response</i>	212	1
Other	1,237	615
<b>Total</b>	<b>3,400</b>	<b>1,322</b>

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

Agree

Disagree

# Further Funding Decisions



# COVID-19 Response and Recovery Fund and further cost of living support

Following advice from the Treasury, I propose closing the COVID-19 Response and Recovery Fund on 11 April 2022. As at 21 March 2022, the remaining balance of the CRRF is \$6.0 billion. **I expect approximately \$3.0 billion to be remaining in the CRRF after known requests for CRRF funding are met.**

Ministers are also considering a new payment to respond to cost of living pressures which could be funded from reprioritising part of the remaining CRRF allowance.

I propose managing the remaining CRRF allowance as follows, with the exact quantum to be determined following our agreement to a final package and Cabinet's agreement to upcoming CRRF requests:

- ❑ \$1 billion (\$250 million per annum) to be reprioritised and used to offset the Budget 2022 operating allowance
- ❑ Indicatively <sup>[33]</sup> reprioritised for a cost of living payment\*
- ❑ The remaining <sup>[33]</sup> billion to be set aside to establish a ring-fenced COVID-19 related contingency (with the exact amount to be determined depending on outcomes of the decisions on potential charges listed above).

I will present my preferred option to Cabinet for agreement on 11 April 2022.

\*Costing is based on indicative settings of a \$350 payment to individuals aged 18 and over, with an income of at least \$1 and less than \$70,000, and not receiving the Winter Energy Payment.

# Fiscal Strategy



# Moving Towards New Fiscal Rules

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**.

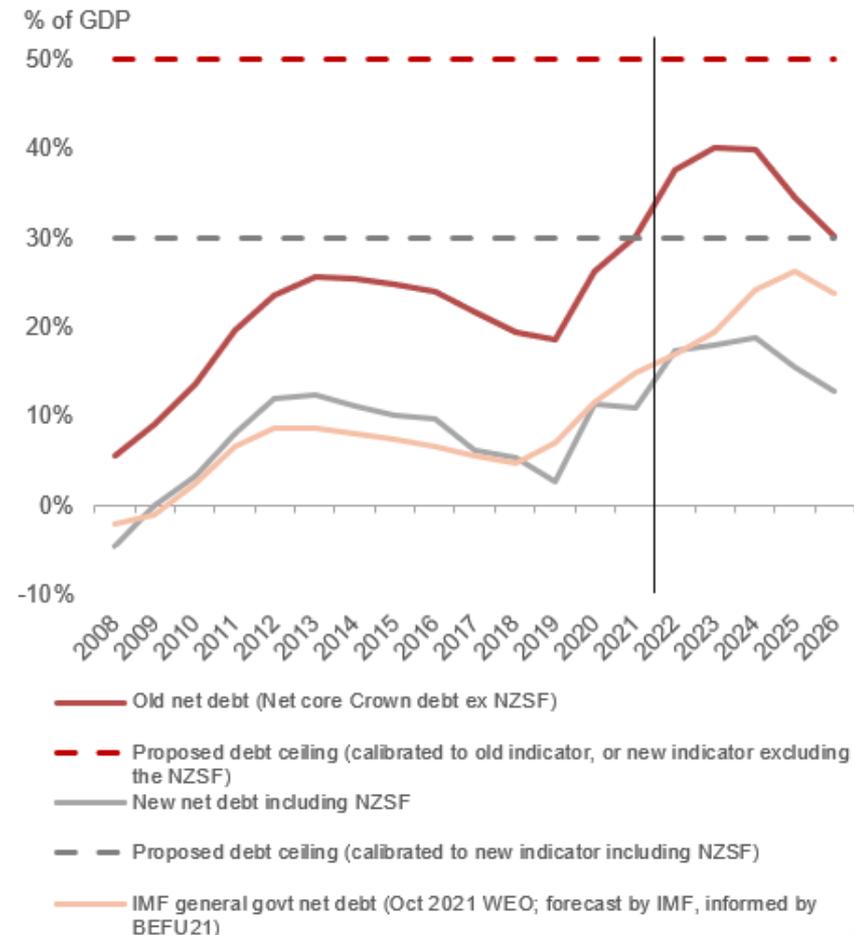
I propose **focusing on the operating balance before gains and losses (OBEGAL) as the main fiscal rule going forward**. This supports intergenerational equity and is likely to result in a fiscally sustainable position. The target should be a **small operating surplus** to ensure that operating expenses do not add to net debt as a share of GDP over time.

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 propose we ensure that **we only fund high-quality, long-term investments that enhance productivity and improve living standards**.

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



# Short-Term Intentions and Long-Term Objectives for the FSR 2022

- The Public Finance Act (PFA) requires the Government to set short-term intentions and long-term objectives for five variables (total debt, total operating expenses, total operating revenue, the operating balance, and net worth).
- For the purpose of achieving our fiscal strategy, I propose focusing on **net debt and OBEGAL**.
  - The new regime will be targeting small operating surpluses in the long run. I plan to **return to surplus in 2024/25**, the first year the preliminary BEFU forecast shows a surplus. Note that if we set a specific target year, there is a risk that we may not be able to meet the intention and may need to revise the target. Are we comfortable with targeting 2024/25?
  - The proposed debt ceiling gives us significant fiscal space to borrow for long-term capital investment. I plan to communicate that this **fiscal space will only be used to support high-quality investment** which will enhance living standards rather than other types of spending.
  - Changing the net debt measure so it includes the NZSF will lower the debt ceiling by 20% of GDP (from 50% of GDP under the old net debt measure to 30% of GDP if we include the NZSF). This entails some communication risks. To help address this risk I plan to **publish both the old and the new net debt indicator**.

Fiscal Variable	Suggested short-term intention for FSR 2022	Suggested long-term objectives for FSR 2022
<b>Debt</b>	<p>Maintain net debt at below 30% of GDP based on new net debt measure including the NZSF, subject to significant shocks.</p> <p>Net debt is forecast to peak at just below 20% of GDP in 2023/24 and reduces over the forecast period to 14% of GDP in 2025/26.</p>	Maintain net debt at below 30% of GDP based on new net debt measure including the NZSF, subject to significant shocks.
<b>Operating balance</b>	Our short-term intention is to return to an operating surplus (before gains and losses) by 2024/25, subject to economic and fiscal conditions.	Once the operating balance (before gains and losses) has returned to a surplus, our long-term objective is to maintain an average surplus in the range of 0-2% of GDP, subject to economic and fiscal conditions.

Note that to meet the PFA requirements, the short-term intentions and long-term objectives for debt and the operating balance will also explain how net debt and OBEGAL translate to total debt and the operating balance.

# Next steps

