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Office of the Minister of Finance

Chair, Cabinet

Wellbeing Budget 2022: Strategy and Design

Proposal

1 This paper seeks approval of the strategy and design of Budget 2022.

Relation to government priorities

2 The Government's goals for this term are:

2.1 Keeping New Zealanders safe from COVID-19

2.2 Accelerating the recovery and rebuild from the impacts of COVID-19, and

2.3 Laying the foundations for the future, including addressing key issues such as climate change, housing affordability and child poverty.

3 The strategy and design of Budget 2022 will ensure that we continue to make progress against these goals, particularly in terms of addressing future issues such as climate change.

Executive Summary

4 Budget 2022 provides a key opportunity to progress our priorities for this term, including implementing reforms that address the long-term challenges facing New Zealanders.

5 The New Zealand economy has recovered faster and more strongly than expected at Budget 2021, and inflation is the highest it has been in a decade. However, the economic outlook remains highly uncertain, with significant risks as evidenced by the current COVID-19 outbreak.

6 The Government's fiscal position is also likely to be stronger than what was forecast at Budget 2021. However, the current COVID-19 domestic resurgence could have a significant impact on the fiscal position, depending on the duration of Alert Levels 3-4 and the level of government support provided over this time period. Despite the improved economic outlook, it is still important to ensure we are providing adequate support to people, businesses and our health system as we manage through changes in Alert Levels. The current fiscal outlook puts us in a good position to continue providing this support. A clearer picture of the fiscal position will be available when the Treasury's Half Year Economic and Fiscal Update is released later this year.

- 7 The improved economic and fiscal outlook will also have implications for the Government's fiscal strategy heading into Budget 2022. I will be revisiting this strategy, including operating and capital allowances, as part of developing the Budget Policy Statement 2022.
- 8 This is our fourth Wellbeing Budget and I have strong ambitions for what we can achieve through Budget 2022. Alongside making progress on the Government's goals for this term, we also have the opportunity to implement a set of reforms that better address the long-term challenges facing New Zealanders.
- 9 The proposed design of Budget 2022 can be broken down into three streams:
 - 9.1 **Core Budget process:** manifesto commitments and cost pressures.
 - 9.2 **Addressing long-term challenges through multi-year funding:** Climate Response Fund and health reforms.
 - 9.3 **Public Finance System modernisation:** Natural Resources and Justice clusters.
- 10 The core Budget 2022 process will be focussed on continuing to make progress on meeting the Government's manifesto commitments as well as addressing critical cost pressures facing key public services. The design of this part of the process closely aligns with that of Budget 2021.
- 11 Alongside this, Budget 2022 will also make a step change in how the Government invests to address long-term challenges by embedding new multi-year funding approaches in the areas of health and climate change. I am also piloting changes to the Public Finance System by establishing the Natural Resource and Justice clusters.
- 12 As in Budget 2021, I propose that Budget 2022 be invitation only, meaning that Ministers will only be able to submit initiatives on the invitation of the Minister of Finance. I will also continue to place high importance on ensuring that investments represent best value for money and can be delivered efficiently and effectively.

Economic and Fiscal Outlook

Economic context

- 13 The New Zealand economy has recovered faster and more strongly than expected, with real GDP growth of 1.6% in the March 2021 quarter seeing real GDP 0.8% above pre-COVID-19 levels. The strength of the recovery has increasingly been apparent in the labour market with unemployment also back at pre-COVID-19 levels.

- 14 Firms are reporting significant cost pressures and given the strength of demand are more confident in increasing prices. These pressures include more temporary supply chain issues of uncertain duration as well as more persistent factors. There has been a rapid and marked change to the outlook for interest rates, with market expectations that the Reserve Bank of New Zealand will soon raise the Official Cash Rate (OCR) if the current COVID-19 outbreak is quickly contained.
- 15 Supply constraints have become a bigger factor for the growth outlook with lack of demand much less of a concern at the economy-wide level (although will remain a concern in industries reliant on foreign visitors). Forward-looking indicators point to continued momentum in demand, while firms are reporting that it is increasingly difficult to find skilled and unskilled labour. A mismatch between the skills available and the skills businesses need is feeding through to higher wage inflation.
- 16 The economic outlook remains highly uncertain, with significant upside and downside risks. In particular, the evolution of COVID-19 remains a key source of uncertainty as demonstrated by the latest outbreak requiring a return to alert level 4 settings. The impact of an extended period at Alert Level 3 or 4 is difficult to measure. The experience from last year is that it is significant, but transitory. We will monitor this closely as we prepare the Budget.
- 17 The phased introduction of the individual risk-based approach to border settings in 2022 will be influenced by the vaccine rollout and developments abroad and will enable greater people flows, which will support tourism and provide a possible labour source for some skill-types and industries.

Fiscal context

- 18 The Treasury's fiscal forecasts presented at Budget 2021 showed the Government reducing operating balance before gains and losses (OBEGAL) deficits over the next four years and starting to stabilise the level of net debt by 2024/25.
- 19 The Government's strong public health response to COVID-19 and our plan to secure New Zealand's recovery from COVID-19 has seen the economy recover faster and stronger than expected. As a result, earlier indications suggest that the fiscal position for the year ended 30 June 2021 will be much stronger than the Treasury expected at Budget 2021. Higher tax revenue and lower spending are the key contributors to this improved position and we could see net core Crown debt being at least 3 percentage points of GDP lower than forecast.

- 20 The Treasury is expecting that the stronger tax outturn in the 2021 year will continue into future years which will lead to a lower deficit and net debt track compared to the Budget 2021. However, at this point it is uncertain how the stronger recovery will impact Government expenditure in the future. With higher inflation, stronger wage growth and increasing interest rates now expected it is most likely these factors will lead to an increase in Government expenditure. A clearer picture of the Government's fiscal outlook will be known ahead of the Treasury's Half Year Economic and Fiscal Update.
- 21 The improved economic and fiscal outlook will have implications for the Government's fiscal strategy heading into Budget 2022. I will be revisiting this strategy, including operating and capital allowances, ahead of the Budget Policy Statement. The Treasury has advised that any extra spending will come with a higher risk of adding to supply constraints and inflationary pressures, so it will be important that new spending at Budget 2022 is delivering value for money and contributing to our strategic objectives, such as responding to climate change or reducing child poverty.
- 22 The current COVID-19 domestic outbreak could have a significant impact on the fiscal position, depending on the duration of Alert Levels 3-4 and the level of government support provided over this time period. Despite the improved economic outlook, it is still important and necessary to ensure we are providing adequate support to people, businesses and our health system through changes in Alert Levels. The current fiscal outlook puts us in a good position to continue providing this support.

Building on previous Budgets

- 23 The last four Budgets have made significant progress towards our Government's goals and priorities. In particular, Budget 2021 made a number of significant investments focussed on addressing the long-term challenges facing New Zealand, particularly around child poverty and housing affordability.
- 24 As we move into the Budget 2022 process, we need to maintain a strong focus on delivering the investments that the Government has already committed to, particularly given the capacity constraints across the system that limit significant further investment.
- 25 The Implementation Unit that has been established within the Department of the Prime Minister and Cabinet will continue to work with me to monitor progress on key initiatives, but I expect Ministers and agencies to be able to demonstrate delivery of past investments before asking for new funding through the Budget process.
- 26 There are also other levers available to us to achieve our goals, such as the effective use of regulation. I continue to encourage Ministers to submit non-spending initiatives when developing their proposals for Budget 2022.

Wellbeing objectives

- 27 This is our fourth Wellbeing Budget. Wellbeing means giving people the capabilities to live lives of purpose, balance and meaning to them. The Wellbeing Approach is designed to lead to investments to improve New Zealanders' living standards by tackling long-term challenges as well as addressing the pressures immediately in front of us.
- 28 The Public Finance Act 1989 now requires the Government to set wellbeing objectives through the Budget Policy Statement (BPS) and then report on how these influenced Budget decision-making in the Fiscal Strategy Report. The objectives are medium-term goals which reflect that sustained investment across multiple Budgets is needed to address some of New Zealand's most significant challenges. They are intended to be enduring across multiple Budgets. These objectives are typically separate from short-term Budget priorities, which may change from year to year and are intended to support the choices and trade-offs required as part of Budget decision-making.
- 29 The current wellbeing objectives were developed as part of the Government's first Wellbeing Budget in 2019. This work took a collaborative and evidence-based approach, using the Treasury's Living Standards Framework and incorporating advice from sector experts and the Government's Chief Science Advisors to identify the broad areas with the greatest opportunities to make a difference to New Zealanders' wellbeing.
- 30 I consider that the current wellbeing objectives are still fit for purpose. However, I propose that we make minor wording changes to reflect housing affordability issues more directly and to reflect our ongoing impact from the recovery from the impacts of COVID-19:
- 30.1 **Just Transition** – Supporting the transition to a climate-resilient, sustainable and low-emissions economy.
- 30.2 **Future of Work** – Enabling all New Zealanders and New Zealand businesses to benefit from new technologies and lift productivity and wages through innovation.
- 30.3 **Physical and Mental Wellbeing** – Supporting improved health outcomes for all New Zealanders, including protecting New Zealanders from the impacts of COVID-19.
- 30.4 **Māori and Pacific** – Lifting Māori and Pacific incomes, skills and opportunities, including through access to affordable, safe, and stable housing.
- 30.5 **Child Wellbeing** – Reducing child poverty and improving child wellbeing, including through access to affordable, safe and stable housing.

- 31 I have asked the Treasury to consult the Government's Chief Science Advisors and sector experts on the proposed changes to our wellbeing objectives. I will report back to Cabinet if any further changes need to be made in order for the revised objectives to be included in the BPS 2022.

Focus for Budget 2022

- 32 I propose that Budget 2022 be aimed at continuing to make progress against the Government's overarching goals for this term of:

32.1 Continuing to keep New Zealand safe from COVID-19

32.2 Accelerating the recovery and rebuild from the impacts of COVID-19, and

32.3 Laying the foundations for the future, including addressing key issues such as our climate change response, housing affordability, and child poverty.

- 33 I have also previously signalled that key areas of focus for Budget 2022 would include addressing climate change and embedding health reforms. In particular, Budget 2022 is an opportunity to further strengthen the public health system that has been so critical to our effective COVID-19 response, and position ourselves to better address the economic and environmental impacts of climate change.

Overview of Budget 2022 process

- 34 I have strong ambitions for what we can achieve through Budget 2022, and this is reflected in the increased complexity of the process. Broadly, Budget 2022 can be broken down into three streams:

34.1 **Core Budget process:** manifesto commitments and cost pressures.

34.2 **Addressing long-term challenges through multi-year funding:** Climate Response Fund and health reforms.

34.3 **Public Finance System modernisation:** Natural Resources and Justice clusters.

- 35 The core Budget 2022 process will be focussed on continuing to make progress on meeting the Government's manifesto commitments as well as addressing critical cost pressures facing key public services. The design of this part of the process closely aligns with that of Budget 2021.

- 36 Alongside this, Budget 2022 will also make a step change in how the Government invests to address long-term challenges by embedding new multi-year funding approaches in the areas of health and climate change. I am also proposing to pilot changes to the Public Finance System by establishing the Natural Resource and Justice clusters.

- 37 I propose that Budget 2022 be invitation only and Ministers will only be able to submit initiatives on the invitation of the Minister of Finance. The only exception to this will be the cluster process. I will shortly be sending letters to Ministers summarising the Budget 2022 process and asking them to write back to me on potential initiatives for Budget 2022. I will then take decisions on which initiatives to invite into the Budget 2022 process in October 2021.
- 38 Budget Ministers (the Prime Minister, Minister of Finance, and Associate Minister of Finance Hon Dr Megan Woods) will remain the key decision-making grouping throughout the development of Budget 2022 and will be responsible for recommending a final Budget 2022 package to Cabinet.

Core Budget 2022 process

Manifesto commitments

- 39 During the 2020 General Election, we made a number of policy commitments that will contribute to improved wellbeing outcomes for New Zealanders. We have already made significant progress in meeting these commitments over the last year, but I have consistently signalled that funding would need to be phased across the three Budgets in this term of Government.
- 40 Budget 2022 will continue to focus on ensuring that we meet our manifesto commitments. As in Budget 2021, the scope for manifesto initiatives will be limited to those commitments that are specifically identified in key Government documents, particularly the Labour Party Manifesto and the Speech from the Throne.

Cost pressures

- 41 Cost pressures cover existing services and outputs which are facing wage, price, or volume pressures and where an agency cannot continue to deliver the same level or quality of service within existing baselines.
- 41.1 **Volume pressures:** these can arise from population growth, changes in population characteristics, or changes in the economic environment. They are client driven and include pressures arising from a reduction in third party revenue.
- 41.2 **Personnel and wage pressures:** these include pressures associated with bargaining and remuneration outcomes and/or due to progression. They do not include generic wage pressures.
- 41.3 **Price pressures:** these not only include changes in cost of inputs (e.g. as a result of inflation), but also changes in capital-related operating expenditure resulting from increases in the value of capital assets.

- 42 While we have made significant progress in addressing cost pressures over the past four Budgets, pressures across the system are still significant and growing. Budget 2022 will need to continue investment in core public services which support the wellbeing of New Zealanders.
- 43 For cost pressure initiatives for Budget 2022, I expect Ministers and agencies to demonstrate:
- 43.1 a clear understanding of the most significant cost drivers across their portfolio that are creating these pressures
 - 43.2 that a high level of risk is attached to not funding these pressures, such as service failure, significant disruption to services, or not meeting legislative requirements
 - 43.3 where funding has already been provided in past funding rounds to manage these pressures, how this has been used and why further funding is required, and
 - 43.4 what efforts have been made, or are being made, to manage these pressures within baselines, including reprioritising lower-value funding and/or reviewing current policy settings.

Addressing long-term challenges through multi-year funding

Climate Emergency Response Fund

- 44 Climate change is one of the most pressing long-term challenges facing New Zealand. Our response to it requires us to make investments over long time horizons and stretching across multiple Budgets. However, the current system of budgeting focusses on the short-term and is not well suited to addressing issues requiring long-term investment.
- 45 At Budget 2021, I signalled that we will take a new approach to funding action on climate change by recycling the revenue from the Emissions Trading Scheme. As part of Budget 2022, the Minister of Climate Change and I are proposing to establish a Climate Response Fund, to be allocated through the annual Budget process toward climate change objectives.
- 46 To align with the release of the Government's first Emissions Reduction Plan (ERP) at the end of this year, we are recommending a focus on emissions reduction for the Fund in Budget 2022. Initiatives seeking funding from the Fund will be required to meet one or more of the following criteria:
- 46.1 the initiative is included in the ERP
 - 46.2 the initiative will directly reduce emissions
 - 46.3 the initiative's primary objective is to support, remove barriers to, or accelerate emissions reductions

46.4 the initiative will support an ao Māori approach to climate response,

46.5 the initiative would facilitate the development of such proposals in future (such as feasibility studies or business cases for such initiatives), or

46.6 the initiative addresses the distributional impacts of emissions reduction policy.

- 47 Our intention is that this Fund be an enduring feature of all future Budgets. We want to signal an enduring pipeline for climate expenditure and incentivise the development of high-quality initiatives to meet our climate objectives. We also want to take a collaborative approach for making investment decisions from the Fund by drawing on the expertise of Climate Chief Executives and Climate Response Ministers.
- 48 The Minister of Climate Change and I will report back to Cabinet before 31 October on the broader climate funding and financing work programme.

Health reforms

- 49 The Government has work under way for the transition to a truly national public health service that delivers for all New Zealanders and places a greater focus on primary and community care. Earlier this year, the Minister of Health outlined plans to replace DHBs with one national organisation (Health New Zealand), establish a new Māori Health Authority to drive hauora Māori and directly commission health services, and create a dedicated Public Health Agency. Budget 2021 provided an initial tranche of funding to get these vital reforms underway, but there is more to do.
- 50 Through Budget 2022, we will need to provide further investment to establish the new entities on a sustainable footing and ensure the success of the new system operating model. This means recognising and meeting the true cost of the existing system, and ensuring that through reform the existing provision of health services is maintained for New Zealanders. But we also need to rethink how we fund the health system in order to incentivise better planning and set harder budget constraints.
- 51 For Budget 2022, we are proposing to take a transitional approach by developing a two-year funding package to provide health sector agencies with funding certainty across the transition period. This two-year package will carry the expectation that the health system will not seek further funding in Budget 2023. This would be followed by embedding a new approach to fiscal management and funding for the health sector from Budget 2024 onwards. The Minister of Health and I will report to Cabinet in September 2021 seeking agreement to these proposals.

- 52 We also need to recognise that there are some current issues and cost pressures in the health system that will need attention, including the public health response to COVID-19 and ensuring the wider health system has the capability to deal with resurgences of COVID-19. Addressing these needs will have to be balanced with supporting the transition programme

Public Finance System modernisation - Natural Resources and Justice clusters

- 53 I have developed a number of longer-term policy proposals focussed on modernising New Zealand's Public Finance System, including:
- 53.1 Organising agencies into clusters to enhance collaboration and enable Ministers to collectively direct spending and make trade-offs across related areas of spending.
 - 53.2 Developing cluster priorities, which draw from our all-of-government priorities and focus on better wellbeing outcomes for New Zealanders, to inform investment decisions.
 - 53.3 Undertaking reviews to assess the efficiency and effectiveness of existing spending and determine future funding requirements.
 - 53.4 Adopting a multi-year cycle by moving clusters onto a three-year funding path.
- 54 Through Budget 2022, I am piloting these changes by establishing two clusters (Natural Resources and Justice) on a non-statutory basis to inform Budget 2022 decisions. Both clusters are governed by groups of Ministers, who are overseen by a lead Minister (Minister Faafoi for Justice and Minister Parker for Natural Resources).
- 55 As part of this pilot, cluster agencies and Ministers will work together to develop multi-year proposals (informed by spending reviews) to seek funding for cost pressures and new policy initiatives, and propose any reprioritisation of existing funding, to cover Budgets 2022-2024. The intention is that clusters will not need to seek additional funding until Budget 2025, apart from a few exceptions agreed on a case-by-case basis.
- 56 I have asked Ministers from the Justice and Natural Resources clusters to develop cluster level priorities to help inform investment decisions for Budget 2022. I will work with cluster Ministers to finalise these priorities. I seek Cabinet's authorisation for Budget Ministers to take final decisions on approval of these priorities.

Expectations and requirements around initiatives

Value for money

- 57 Value for money is about understanding and achieving value from a uniquely Aotearoa New Zealand perspective: achieving the results we want, delivered efficiently and effectively. It has three components:
- 57.1 **Value** - wellbeing results, incorporating wellbeing understood from a te ao Māori perspective through the He Ara Waiora framework
 - 57.2 **Alignment** - with the Government's wellbeing objectives and whole-of-government and sectoral strategies, and
 - 57.3 **Delivery** - assurance of effective and efficient delivery of the outputs we are purchasing.
- 58 This approach builds on previous Budgets, but provides a more systematic basis for Ministers to prioritise initiatives, with wellbeing being a part of value for money rather than a separate consideration.
- 59 For Budget 2022, I propose we focus on ways to support agencies to develop exemplary Budget initiatives to support our decision-making. This will contribute to our long-term goal of embedding high-quality value for money end-to-end in the Budget management system – from strategic planning through to monitoring and evaluation of outcomes.

Capital

- 60 To maximise the value we deliver through this Budget, we need to ensure that funding is allocated to those investments that are best placed to deliver the promised results. I expect potential capital Budget initiatives to have undertaken and demonstrate sufficient planning and prioritisation. This includes the robust thinking and planning required by the business case process, the appropriate assurance from across the Investment Management System, and the necessary collaboration across agencies.
- 61 In the assessment of initiatives, our investment decisions will have to be shaped by achievability (the delivery risks and the capacity constraints) alongside the attractiveness of the promised benefits. In some cases, deferral of initiatives to future Budgets to allow further work to be undertaken may deliver better outcomes.

Future of the CRRF

- 62 I believe it is necessary to retain the COVID-19 Response and Recovery Fund (CRRF) for the foreseeable future. The current outbreak will require significant resources, and I have asked for advice on whether we will need to replenish the fund before the end of the year.

- 63 In light of this, I consider that we need to significantly tighten the focus of the CRRF towards meeting the needs of our direct response to COVID-19. Recovery funding from the CRRF has played a key role in supporting the economy through the pandemic, but it also means that there is not a clear need for further fiscal stimulus at this point. Meanwhile, agencies should also be considering how they revise their operating models to deal with COVID-related costs rather than seeking new CRRF funding.
- 64 I propose to revise the purpose of the CRRF to “meeting the costs of the direct response to the COVID 19 pandemic over the next year”. As part of this refocussing, I also propose to refine the criteria for accessing the CRRF and limit it to the following areas only:
- 64.1 Core economic response measures to deal with a resurgence, including the Wage Subsidy Scheme, Resurgence Support Payment, Short-term Absence Payment, and Leave Support Scheme
 - 64.2 Targeted policy responses to the immediate impacts of resurgence-related restrictions on particular demographic groups
 - 64.3 Urgent cost pressures that government agencies are facing as part of responding to a COVID-19 resurgence (with a focus on key response agencies), and
 - 64.4 Essential public health measures which reduce the risk of resurgences.
- 65 I expect that any new CRRF funding will be provided on a strictly time-limited basis, and agencies will have to demonstrate that costs cannot be met through reprioritisation of existing baseline funding. In the context of the current resurgence, I note there is likely to be greater scope for agencies to manage costs within baselines given that we are still early in the financial year.
- 66 Ongoing tracking and transparency of COVID-related spending remains important. When new CRRF funding is agreed, I expect agencies to clearly specify what reporting mechanisms will be put in place. Where the funding is not going into an appropriation that has been identified as a COVID-19 specific appropriation, I expect that expenditure to be separately tracked and reported on.
- 67 In the context of the current resurgence, I am not proposing to run a coordinated CRRF funding round at this point.

Timeframes

- 68 Table 1 provides an overview of the key milestones for the Budget 2022 process, with a particular focus through to the end of the year. Detailed timeframes will be made available to agencies through the guidance that the Treasury will release by the end of September 2021.

Table 1: Budget 2022 timeframes

Date	Key milestone
Monday 30 August	Budget 2022 Strategy and Design paper considered by Cabinet
Week of 30 August	Budget strategy letters to portfolio Ministers
Thursday 23 September	Ministers submit initiative intention letters (excludes cluster portfolios)
By end of September	Budget 2022 guidance for agencies released (for all initiative types)
Monday 18 October	Budget 2022 invitations sent
Friday 10 December	All Budget 2022 initiatives due to be submitted in CFISnet
Mid-December	<i>Half Year Economic and Fiscal Update and Budget Policy Statement</i>
December to February	Treasury assessment of initiatives; potential bilateral meetings
Monday 4 April	Budget 2022 package paper expected to be considered by Cabinet

Financial Implications

69 There are no direct financial implications arising from the proposals in this paper.

Legislative Implications

70 There are no legislative implications associated with the proposals in this paper.

Impact Analysis

Regulatory Impact Statement

71 There are no regulatory implications associated with the proposals in this paper.

Climate Implications of Policy Assessment

72 As part of the Climate Response Fund process, initiatives being considered will provide information to inform CIPA analysis where they have emissions reduction impacts. They will also provide shadow carbon pricing of their CIPA outputs.

Population Implications

73 The analysis required through Budget 2022 will support a stronger focus on the distributional impacts of initiatives.

Human Rights

- 74 The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

- 75 This paper was prepared by the Treasury on behalf of the Minister of Finance. The Department of the Prime Minister and Cabinet was informed.

Communications

- 76 I will shortly be sending letters to Ministerial colleagues summarising the Budget 2022 process and asking them to write back to me by 23 September 2021 on potential initiatives for Budget 2022. I will take decisions on which initiatives to invite into the Budget 2022 process in October 2021.
- 77 Guidance for agencies on the Budget 2022 process will be issued by the Treasury in late September 2021.
- 78 The Half Year Economic and Fiscal Update and Budget Policy Statement 2022 will be released later this year. In advance of this, I will report back to Cabinet to seek agreement to potential changes to Budget allowances.

Proactive Release

- 79 I propose delaying the release of this paper beyond the standard 30 business days as it will be released separately through the Budget 2022 proactive release.

Recommendations

The Minister of Finance recommends that Cabinet:

Economic and fiscal outlook

- 1 **note** that the New Zealand economy has made a stronger recovery than previously expected, with real GDP 0.8% above pre-COVID levels and unemployment rate below pre-COVID levels;
- 2 **note** that the economic outlook remains highly uncertain, with significant risks, including continued momentum in demand, worsening supply constraints, and COVID-19 uncertainty as evidenced by the recent outbreak;
- 3 **note** that the Government's fiscal outlook will also likely improve relative to Budget 2021 forecasts, with a clearer picture available at the Half-Year Economic and Fiscal Update;

- 4 **note** that the Minister of Finance intends to revisit the Government's fiscal strategy, including operating and capital allowances, ahead of the Budget Policy Statement 2022;

Building on past Budgets

- 5 **note** that Ministers and agencies need to maintain a strong focus on delivering the significant investments that the Government has already committed to over the past four Budgets;
- 6 **note** that new spending is not the only lever available to achieve the Government's goals, and Ministers and agencies should also be considering the effective use of regulation and reprioritising existing expenditure;

Wellbeing objectives

- 7 **note** that the Public Finance Act 1989 requires the Government to set wellbeing objectives in the Budget Policy Statement and to explain in the Fiscal Strategy Report how wellbeing objectives have guided the Government's Budget decisions;
- 8 **note** that the Minister of Finance considers that the existing wellbeing objectives are largely fit for purpose, but require minor updates to reflect housing affordability issues more directly and New Zealand's ongoing recovery from the impacts of COVID-19;
- 9 **agree**, subject to the consultation referred to in recommendation 10, that the revised wellbeing objectives for Budget 2022 be:
 - 9.1 Just Transition – Supporting the transition to a climate-resilient, sustainable and low-emissions economy.
 - 9.2 Future of Work – Enabling all New Zealanders and New Zealand businesses to benefit from new technologies and lift productivity and wages through innovation.
 - 9.3 Physical and Mental Wellbeing – Supporting improved health outcomes for all New Zealanders, including from COVID-19
 - 9.4 Māori and Pacific – Lifting Māori and Pacific incomes, skills and opportunities, including through access to affordable, safe, and stable housing.
 - 9.5 Child Wellbeing – Reducing child poverty and improving child wellbeing, including through access to affordable, safe and stable housing.

- 10 **note** that the Minister of Finance has asked the Treasury to consult the Government's Chief Science Advisors and sector experts on the proposed changes to the Government's wellbeing objectives;

Focus of Budget 2022

- 11 **agree** that Budget 2022 will continue to make progress against the Government's overarching goals for this term of:
- 11.1 Continuing to keep New Zealand safe from COVID-19;
 - 11.2 Accelerating the recovery and rebuild from the impacts of COVID-19; and
 - 11.3 Laying the foundations for the future, including addressing key issues such as our climate change response, housing affordability, and child poverty.
- 12 **agree** that key areas of focus for Budget 2022 include addressing climate change and embedding health reforms;

Overview of Budget 2022 process

- 13 **agree** that the Budget 2022 process be divided into the following three streams:
- 13.1 Core Budget process: manifesto commitments and critical cost pressures.
 - 13.2 Addressing long-term challenges through multi-year funding: Climate Response Fund and health reforms.
 - 13.3 Public Finance System modernisation: Natural Resources and Justice clusters.
- 14 **agree** that Budget 2022 will be invitation only, meaning that (with the exception of the clusters in recommendation 13.3 above) Ministers will be able to submit initiatives only following an invitation from the Minister of Finance;
- 15 **agree** that Budget Ministers (Prime Minister, Minister of Finance, and Associate Minister of Finance, Hon Dr Megan Woods) remain the key decision-making body responsible for recommending to Cabinet a final Budget 2022 package covering all three streams;

Core Budget 2022 process

- 16 **note** that the Government has made a number of policy commitments through its manifesto documents that will contribute to improved wellbeing outcomes for New Zealanders;

- 17 **note** that while the Government has made significant progress in addressing cost pressures in core public services over the past four Budgets, pressures across the system are still significant and growing;
- 18 **agree** that the core Budget 2022 process will focus on continuing to meet the Government's manifesto commitments and critical cost pressures across core public services;
- 19 **agree** that manifesto initiatives will be limited to those commitments that are specifically identified in key Government documents, particularly the Labour Party Manifesto 2020 and the Speech from the Throne 2020;
- 20 **agree** that for critical cost pressure initiatives each portfolio Minister and their agencies will be expected to demonstrate:
 - 20.1 a clear understanding of the most significant cost drivers across their portfolio that are creating these pressures,
 - 20.2 that a high level of risk is attached to not funding these pressures, such as service failure, significant disruption to services, or not meeting legislative requirements,
 - 20.3 where funding has already been provided in past funding rounds to manage these pressures, how this has been used and why further funding is required, and
 - 20.4 what efforts have been made, or are being made, to manage these pressures within baselines, including reprioritising lower-value funding and/or reviewing current policy settings

Addressing long-term challenges through multi-year funding

- 21 **note** that climate change is one of the most pressing long-term challenges facing New Zealand, and the Government's response will need to involve making investments over long time horizons and stretching across multiple Budgets;
- 22 **agree** to establish a Climate Emergency Response Fund as part of Budget 2022;
- 23 **agree** that the focus of the Climate Emergency Response Fund in Budget 2022 will be emissions reduction, with the following criteria for eligibility:
 - 23.1 the initiative is included in the Emissions Reduction Plan,
 - 23.2 the initiative will directly reduce emissions,
 - 23.3 the initiative's primary objective is to support, remove barriers to, or accelerate emissions reductions,

- 23.4 the initiative will support an ao Māori approach to climate response,
- 23.5 the initiative will facilitate the development of such proposals in the future (such as feasibility studies or business cases for such initiatives, or
- 23.6 the initiative addresses the distributional impacts of emissions reduction policy;
- 24 **note** that the Minister of Finance and Minister of Climate Change will report back to Cabinet before 31 October 2021 on the broader climate funding and financing work programme;
- 25 **note** that the Government has committed to a set of transformative health reforms which will require significant investment through Budget 2022 in order to establish the new entities on a financially sustainable footing and ensure the success of the new system operating model;
- 26 **note** that government also needs to rethink how the health system is funded in order to incentivise better planning and set harder budget constraints;
- 27 **agree-in-principle**, subject to the report back in recommendation 29 below to take a transitional approach for Budget 2022 by developing a two-year funding package to provide health sector agencies with funding certainty across the transition period 2022/23 and 2023/24;
- 28 **note** that the Minister of Finance and Minister of Health are proposing to introduce a new approach to fiscal management and funding for the health sector from Budget 2024 onwards;
- 29 **note** that the Minister of Finance and Minister of Health will report to Cabinet in September 2021 seeking agreement to the detail of the proposals referred to in recommendations 27 and 28 above;

Public Finance System modernisation – Natural Resources and Justice clusters

- 30 **note** that the Minister of Finance has developed a number of longer-term policy proposals to modernise the Public Finance System, including:
- 30.1 Organising agencies into clusters to enhance collaboration and enable Ministers to collectively direct spending and make trade-offs across related areas of spending.
- 30.2 Developing cluster priorities, which draw from our all-of-government priorities and focus on better wellbeing outcomes for New Zealanders, to inform investment decisions.
- 30.3 Undertaking reviews to assess the efficiency and effectiveness of existing spending and determine future funding requirements.

30.4 Adopting a multi-year cycle by moving clusters onto a three-year funding path.

- 31 **agree** to pilot the changes referenced in recommendation 30 by establishing two clusters (Natural Resources and Justice) on a non-statutory basis which will develop multi-year funding proposals for cost pressures and new spending to cover Budgets 2022-2024;
- 32 **note** that the Minister of Finance is currently working with relevant Ministers to develop cluster level priorities to inform investment decisions for Budget 2022;
- 33 **authorise** Budget Ministers to approve the cluster priorities referenced in recommendation 32;

Expectations and requirements for initiatives

- 34 **note** that Budget 2022 will continue to have a strong focus on ensuring that potential investments represent best value for money;
- 35 **note** that the approach to value for money in Budget 2022 will be about understanding and achieving value from a uniquely Aotearoa New Zealand perspective and has three components:
- 35.1 Value - wellbeing results, incorporating wellbeing understood from a te ao Māori perspective through the He Ara Waiora framework,
- 35.2 Alignment - with the Government's wellbeing objectives and whole-of-government and sectoral strategies, and
- 35.3 Delivery - assurance of effective and efficient delivery of the outputs we are purchasing.
- 36 **note** that the Minister of Finance also expects capital initiatives to demonstrate sufficient planning, prioritisation, and implementation-readiness in order to receive funding;

Timeframes

- 37 **note** that the Minister of Finance will shortly send letters to Ministers summarising the Budget 2022 process and asking them to write back on potential initiatives for Budget 2022;
- 38 **note** that the Minister of Finance will take decisions on which initiatives to invite into the Budget 2022 process in October 2021, and initiatives will need to be submitted to the Treasury by 10 December 2021;
- 39 **note** that more detailed timeframes for the Budget 2022 process will be made available through the guidance to agencies that the Treasury will release in late September 2021;

Future of the COVID-19 Response and Recovery Fund (CRRF)

- 40 **note** that the Minister of Finance has requested further advice from the Treasury on whether the fund should be replenished;
- 41 **note** that the Minister of Finance considers that the Government should significantly tighten the focus of the CRRF towards meeting the needs of the direct response to COVID-19;
- 42 **agree** that the revised purpose of the CRRF be “meeting the direct costs of responding to any COVID-19 resurgences over the next year”;
- 43 **agree** to refine the criteria for accessing the CRRF so it is limited to the following areas only:
- 43.1 Core economic response measures to deal with a resurgence, including the Wage Subsidy Scheme, Resurgence Support Payment, Short-term Absence Payment, and Leave Support Scheme
 - 43.2 Targeted policy responses to the immediate impacts of resurgence-related restrictions on particular demographic groups
 - 43.3 Urgent cost pressures that government agencies are facing as part of responding to a COVID-19 resurgence (with a focus on key response agencies), and
 - 43.4 Essential public health measures which reduce the risk of resurgences.
- 44 **agree** that new CRRF funding should be provided on a strictly time-limited basis, agencies should have to demonstrate that costs cannot be met through reprioritisation of existing baseline funding, and there should be reporting mechanisms in place;
- 45 **note** that, in the context of the current resurgence, I will consider proposals for funding from the CRRF on a case by case basis, and that Cabinet approval will be sought for these proposals, outside of any existing delegations.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance