

The Treasury

Budget 2022 Information Release

August 2022

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- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [36] 9(2)(h) - to maintain legal professional privilege
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [40] Out of Scope
- [41] 18(c)(i) - that the making available of the information requested would be contrary to the provisions of a specified enactment
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Treasury Report: Budget 2022 – Options for Draft Package

Date:	11 February 2022	Report No:	T2022/6
		File Number:	BM-2-4-2022-5

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Discuss the strategic choices and options to support developing the Budget 2022 package with officials at Budget Matters on 14 February 2022.	14 February 2022

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Laura King	Senior Analyst, Budget Management [39]	N/A (mob)	
Simon Duncan	Manager, Budget Management	[35]	✓

Minister of Finance's Office Actions (if required)

Return the signed report to the Treasury.

Note any feedback on the quality of the report

Enclosure: Yes (attached)

Treasury Report: Budget 2022 – Options for Draft Package

Executive Summary

Budget 2022 is ambitious in its scope and scale of proposed investment...

Budget 2022 provides the opportunity to make significant progress towards your Government's goals, and achieve a step-change in how government invests to address long-term challenges around health and climate change.

Through the Budget Policy Statement 2022 (BPS), you indicated that substantial investment would be needed to address these issues through setting Budget allowances that were substantially higher than pre-COVID. In particular, you indicated:

- an operating allowance of \$6.0 billion per annum for Budget 2022
- a multi-year capital allowance of \$9.8 billion for the next four Budgets, and
- the establishment of a \$4.5 billion Climate Emergency Response Fund.

Compared to these Budget 2022 allowances, Ministers have sought \$11.2 billion operating funding per annum and \$8.6 billion capital investment. Following submission, Treasury Vote teams have assessed initiatives and recommended significant scaling and deferring of initiatives. Even so, the operating allowance for Budget 2022 is still oversubscribed with the draft Budget 2022 package totalling [33] per annum (including pre-commitments) compared to your \$6.0 billion allowance. There are also upcoming decisions which will have implications for the allowances, for example choices around depreciation revaluation charges. The draft capital package totals [33]. While this can be met within the existing multi-year capital allowance it leaves little capital funding for future Budgets.

...but the economic environment is also uncertain. . .

Budget 2022 is being developed in an increasingly challenging economic environment. Annual inflation rose to 5.9% in the December 2021 quarter due to the impact of supply chain disruptions and domestic capacity constraints combined with strong demand. The Omicron outbreak has introduced further uncertainty to an already complex economic picture. While these factors are expected to ease over time, higher levels of inflation are likely to persist at least for the rest of this year. Core Crown expenses have grown from \$81 billion in 2018 to a forecast of \$128 billion in the current financial year.

... and there are constraints on the ability of the public sector to deliver.

Alongside the direct impacts on households and businesses, market constraints are also limiting the public sector's ability to deliver on the Government's sizeable work programme of investment and reforms. This is particularly acute in the labour market space where Ministers are proposing significant growth in the public sector workforce.

Managing within allowances will require trade-offs...

Given this context, we recommend that you continue to target a Budget 2022 package that fits within the Budget allowances signalled at the BPS. In order to ensure that the significant amount of spending being proposed will deliver on your Government's ambitions for Budget 2022, we also recommend paying careful attention to the composition of any additional spending with respect to value-for-money and deliverability.

... but there are levers available to you to manage within Budget allowances.

To support managing within a \$6.0 billion per annum operating allowance for Budget 2022 we recommend you consider:

- the scope of investment in health system transformation to be progressed for Budget 2022
- the level of investment in Education, and the Natural Resources and Justice clusters, and
- further scaling of the cost pressure and manifesto sub-packages.

We suggest that you first consider changes to the health and education sub-packages, given the size of investment being proposed. There may be marginal gains available in the cluster, cost pressure and manifesto sub-packages, but these are expected to be relatively minimal.

At this point in the Budget 2022 process, savings options are limited. However, if you are interested in exploring savings options, we recommend you start by reviewing the amount of funding held in existing tagged contingencies (\$10.6 billion operating and \$6.7 billion capital over the forecast period).

Budget Ministers 3 and bilateral meetings are the next key milestones in the Budget process.

We are meeting with you at 8:30am on Monday 14 February to discuss the key choices around forming a Budget 2022 package. In particular, we seek your views on what aspects of the Budget 2022 package you would like to discuss at Budget Ministers 3 on Friday 25 February. You also have a series of bilateral meetings with key spending Ministers over the next few weeks that will allow you to test relative priorities.

Recommended Action

We recommend that you:

- a **note** staying within the Budget 2022 allowances will require some strategic choices, including
 - i. the scope of investment in health system transformation to be progressed for Budget 2022
 - ii. the level of investment in Education, and the Natural Resources and Justice clusters, and
 - iii. further scaling of the cost pressure and manifesto sub-packages.
- b **discuss** the strategic choices and options for the draft Budget 2022 package with officials at Budget Matters at 8:30am on Monday 14 February 2022 (agenda attached)
- c **indicate** which changes, including via the detailed initiative level information in annex 2 you wish to make to the draft Budget 2022 package (including the CERF) that will be considered at Budget Ministers 3

Simon Duncan
Manager, Budget Management

Hon Grant Robertson
Minister of Finance

Treasury Report: Budget 2022 – Options for Draft Package

Purpose of report

1. This report seeks your views on the strategic choices for the design of the Budget 2022 package. Following discussion with officials at Budget Matters on 14 February (agenda attached) and your Ministerial colleagues, Treasury will provide an updated draft Budget 2022 package for your review ahead of Budget Ministers 3.
2. We have also sent you a spreadsheet listing the initiatives submitted by Ministers for your review and the Treasury assessment of these (Annex 2).

Context for Budget 2022

3. Budget 2022 provides the opportunity to make significant progress towards your Government's goals and achieve a step-change in how government invests to address long-term challenges. Through the Budget Policy Statement 2022 (BPS), you signalled that Budget 2022 would have a particular focus on embedding health reforms and addressing climate change, as well as piloting changes to the public finance system through the Natural Resources and Justice clusters.
4. The BPS also indicated that substantial investment would be needed to address these issues through:
 - increasing the operating allowance to \$6.0 billion per annum for Budget 2022 (before precommitments)
 - increasing the multi-year capital allowance (MYCA) by \$4.0 billion to \$9.8 billion, and
 - establishing a \$4.5 billion Climate Emergency Response Fund (before existing charges).

Economic context for Budget 2022 is uncertain

5. Budget 2022 is being developed in a challenging environment. While the *Half Year Economic and Fiscal Update 2021 (HYEFU)* showed a significant improvement in the economic and fiscal outlook compared to Budget 2021, annual inflation rose to 5.9% in the December 2021 quarter due to the impact of supply chain disruptions and domestic capacity constraints combined with strong demand.
6. These factors are expected to unwind over time, but their persistence means that inflation will likely remain elevated at least for the next year. Alongside the direct impacts on households and businesses, these factors are also affecting the deliverability and cost of key investments being made across the public sector. The Omicron outbreak has also introduced further economic uncertainty. You will receive further advice on the Treasury's preliminary economic and tax forecasts for Budget 2022 on 18 February.

7. We recommend that you continue to target a Budget 2022 package that fits within the Budget allowances signalled at the BPS, focusing on the highest value-for-money investments, and exploring options for phasing commitments wherever possible.

Workforce constraints will affect deliverability of initiatives

8. The public sector is also facing workforce constraints due to a tight labour market. We recently provided you with advice (TR2022/54 refers) that consistently high demand for personnel to deliver both existing and new Government programmes will require trade-offs to be made in Budget 2022.
9. Three main factors are affecting workforce deliverability:
 - i. a tight employment market limiting the number of staff available
 - ii. wage inflation pressures increasing the cost of attracting new workforce personnel, and
 - iii. pay guidance restricting the ability to increase salaries to retain key personnel leading to delivery risks. This leaves agencies competing within a limited pool of available personnel.

Treasury's approach to assessing Budget initiatives

10. Through the invitation process you invited approximately 600 initiatives to be submitted for consideration for Budget 2022. Ministers have subsequently sought \$11.2 billion operating funding per annum and \$8.6 billion of new capital investment.
11. The Treasury draft Budget 2022 package has been informed by a bottom-up assessment of the value for money (VfM) of each initiative, combined with high-level trade-offs to ensure that the package meets the Budget 2022 priorities. Our approach to VfM considers the wellbeing impacts of investments and other dimensions including robustness of costings, deliverability, and alignment with wellbeing objectives.

Overview of the draft Budget 2022 package

13. The Budget 2022 package can be broken down into the following sub-packages:
 - a. Health reform (comprised of a cost pressure package and envelopes for new investment, including multi-year funding)
 - b. Education
 - c. Justice and Natural Resources clusters, including multi-year funding
 - d. Other Manifesto commitments and critical cost pressures, including capital investments, and
 - e. The Climate Emergency Response Fund (CERF)

14. Your key considerations to support the development of the Budget 2022 package are:
- i Ensuring the Budget meets your ambitions and that you are achieving value for money.
 - ii What the options and strategic choices are to help manage new spending within existing Budget 2022 allowances.
15. Broadly, the draft Budget 2022 package provides significant investment across your signalled priority areas. The composition of the Budget 2022 draft package is outlined in the tables below. However, the draft package currently exceeds the operating allowance by \$0.4 billion per annum, despite significant scaling of the funding sought by Ministers.

Table 1: Composition of the draft Budget 2022 package

	Sought by Ministers for Budget 2022 ¹	Draft Budget Package		
		Budget 2022 Package	Budget 2023	Budget 2024
	(\$b p.a.)	(\$b p.a.)	(\$b p.a.)	(\$b p.a.)
Operating Allowances	6.0	6.0	4.0	3.0
Pre-commitments	0.8	0.8		
Health Reform	[33]	1.8 (scaled by [33])	1.3	
Health New Spending		0.5 (scaled by [33])		
Education		[38]		
Clusters		0.4 (scaled by [33])	0.4	0.4
Cost Pressure		1.0 (scaled by [33])		
Manifesto		0.9 (scaled by [33])		
Total		[33]	1.7	0.4
FTE, including contractors	7,706	3,615 (scaled by 53%)	-	-

16. The biggest opportunities for keeping the draft Budget package within the Budget 2022 operating allowance can be found in the health and education sub-packages. While some further scaling is possible across clusters, cost pressures and manifesto sub-packages, the gains made from additional scaling here will likely be relatively small.

¹ This column reflects funding sought against the Budget 2022 operating allowance only, not multi-year funding.

Table 2: Composition of the draft Budget 2022 Capital Package

	Sought by Ministers (\$b total)	Draft Budget 2022 Package (\$b total)
Multi-year Capital Allowance	9.8	9.8
Pre-commitments	2.9	2.9
Health Cost Pressures	[33]	[33]
Health New Spending		0.3
Education		0.5
Cost Pressure		1.0
Manifesto		0.3
Total		[33]

17. The draft Budget 2022 capital package is within your \$9.8 billion multi-year capital allowance, however this would allocate most of your MYCA in Budget 2022 alone. This is largely driven by significant capital expenditure in Vote Health and existing pre-commitments. Options around the capital package are discussed later in this report.
18. The Climate Emergency Response Fund (CERF) is a four year ring-fenced funding allocation. It has been established with \$4.5 billion from the Emissions Trading Scheme, based on forecasted proceeds over the next four years. In the first year of the CERF we are proposing you spend [33]

Table 3: Composition of the draft Budget 2022 CERF package

	\$billion multi-year total	
CERF	4.5	
	Operating	Capital
Existing charge - International Climate Finance	0.8	-
Proposed Budget 2022 CERF package	[33]	
Total		
Remaining CERF	1.9	

Health sub-package makes up the majority of allowances

19. Embedding Health reforms is the cornerstone of Budget 2022, reflecting an ambitious system transformation and the beginning of increased funding certainty for Vote Health through a transition to multi-year funding. The importance of the health reforms is reflected in the current size of the health sub-package, which in total represents over a third of your operating allowance for Budget 2022, plus an additional \$1.3 billion to be precommitted against Budget 2023.

20. The health sub-package for Budget 2022 comprises two key elements: the health system rebase and cost pressures, and the new investment package. There is more discretion in relation to the new spending package than for the rebase and cost pressures package.

The health system is under pressure

21. Continued pressure from COVID-19 creates both significant demand on, and significant capacity constraints in, the health system. Many parts of the system are already overwhelmed and at capacity, even without the significant new activity proposed through Budget 2022 new investments.
22. The health system has received investment of over \$8 billion for the public health response to COVID-19 since the start of the pandemic. A further \$3 billion – \$5 billion is expected to be sought from the COVID-19 Response and Recovery Fund (CRRF) in March to continue the public health response in 2022/23.
23. While ongoing investment in public health is a necessary and critical response to COVID-19, the system continues to struggle to deliver some existing programmes. Treasury’s assessment of new investment reflects our best judgements on the capacity for the health system to absorb new investment.

To ensure the health system transformation is successful we recommend focusing first on cost pressures

24. Cabinet agreed that, at its establishment, Health New Zealand should be provided with funding sufficient to establish this entity on a sustainable footing. Treasury’s assessment is based on providing a credible level of funding that will enable the Health NZ Board to plan for, and operate without, a deficit in its first two years. The sharing of planning parameters and the development of the initial draft HNZ budget will be an important input into final Budget 2022 decisions, and will illuminate risk and rationing choices.
25. There are two key initiatives:
- the DHB deficits rebase (which seeks to fund the activity previously incurred as deficits) [33] million per annum), and
 - health system cost pressures (which seek to fund the system for projected pressures based on macroeconomic and demographic assumptions so that it can continue to deliver ‘real flat’ services over the two-year transition period).
26. Treasury has refined the health sub-package from the 2022/23 sought amount of [33] billion for cost pressures and [33] million for new spending to \$1.8 billion for cost pressures and \$487 million for new spending. We consider this level of funding will achieve your goal of embedding health reforms. However, there are opportunities for further scaling, particularly around the level of new investment.
27. The table below outlines some further scaling options:
- Option 2 – Scaling new investment or deferring some investments until they are further developed.

- Option 3 – Further scaling the cost pressure component. This is achieved by applying lower forecast assumptions than the Treasury’s HYEPU forecasts.

Table 4: Health sub-package scaling options

\$b per annum	Option 1: Treasury Draft Package	Option 2: Scaled Health new spending	Option 3: Option 2 plus scaled cost pressures
Operating: Cost Pressure, including rebase	1.8	1.8	1.6
Operating: New Spending	0.5	0.4	0.4
Total Operating	2.3	2.2	2.0
Savings from B22 draft package	-	0.1	0.3

28. [34]

29. We recommend you discuss the key choices around the health sub-package and options for scaling at your bilateral meeting with the Minister of Health on Monday 14 February.

Key choices and questions for discussion at Budget Matters:

- 1) How to balance addressing historic and current pressure in the health system with supporting the transition programme?
- 2) What is your appetite for further scaling the health sub-package?
- 3) Would you like further advice on the ‘residual’ assumption built into the Vote Health cost pressures?

Education sub-package

30. While Education has historically been a significant area of investment for the Government each Budget, it is not an explicit priority area for investment at Budget 2022. Many of the Education initiatives submitted represent strong value for money but remain deferrable.

31. You provided the Minister of Education with an envelope of [38] billion per annum operating [38] to manage Budget initiatives. The Minister of Education submitted a package within the envelope.

32. The [38] billion was an initial figure to support early prioritisation and is unlikely to be manageable within current allowances. We have developed three options representing a more affordable level of investment (including teaching bargaining):

Table 5: Options for Education sub-package

\$b per annum	Option 1: Higher option	Option 2: Treasury Draft Package	Option 3: Minimum Scaled Package
Education Operating	[38]		

33. We have proposed a Treasury Draft Package option of [38] billion operating funding per annum, as this will meet critical cost pressures and fund meaningful progress in some key areas such as Pay Parity in early learning, implementing the Equity Index in schools and investing in Māori-medium property. Option 3 would allow less investment in Manifesto initiatives and Option 1 would allow greater progress to be made within the Education work programme.
34. We have provided you with further advice on Education to support your bilateral discussion with the Minister of Education on Wednesday 16 February 2022 (T2022/117 refers).

Key question for discussion at Budget Matters:

- 4) What is your appetite for further scaling the Education sub-package?

Natural Resources and Justice cluster envelopes

You will receive detailed advice on the cluster spending proposals ahead of Budget Ministers 3

35. The clusters submitted high, medium, and low packages on Friday 4 February. The Justice cluster packages are within the indicative envelopes provided last year, while the Natural Resources cluster packages are all higher. You will receive advice on these packages on Thursday 17 February as part of the final spending review reports. Ahead of more detail advice on cluster packages, we have outlined some of the strategic choices below.

The main choice is whether you use one of the envelopes already provided (i.e. medium or low envelope) or set a new envelope for each cluster

36. You are meeting with both sets of Cluster Ministers on 3 March to discuss their proposed packages and provide them a dollar amount to develop a single final package. To support these conversations, you need to confirm a final envelope amount for each cluster at Budget Ministers 3. You could either choose:
- i. one of envelopes already provided to the clusters, or
 - ii. determine how much you would like to allocate to each cluster after considering the allowance allocation for the other sub-packages.

- 37. To maintain the integrity of the cluster process, we recommend taking all three packages to discuss at Budget Ministers 3. Cluster Ministers were asked to develop high, medium and low packages to provide different options for Budget Ministers to consider when making Budget decisions. It is important that Cluster Ministers have the opportunity submit a single revised package to you on 10 March, following your Thursday 3 March meetings with cluster Ministers.
- 38. Our initial analysis of the packages submitted by clusters is:

Low Package	The low packages only cover funding for scaled departmental cost pressures, which would not enable multi-year funding or realise the benefits of the cluster approach.
Medium Package	The medium packages include initiatives that deliver against Government priorities and would support the objectives of multi-year funding and cluster collaboration. However, there are also options for rephasing and scaling initiatives to tighten the medium packages and improve deliverability, given overall capacity constraints.
High Package	We consider a reasonable amount of discretionary initiatives have been included in the high package. Given the broader pressures on allowances, we would not recommend supporting the high package.

Phasing of the final cluster packages will also have an impact on Budget 2022 allowances

- 39. The phasing outlined in table 1 is the year one funding for clusters. Depending on how you phase the funding profile across future Budgets, multi-year funding can have different impacts on the Budget 2022 allowance. You will receive advice on how to manage multi-year funding within allowances.

Key questions for discussion at Budget Matters:

- 5) In the upcoming advice, would you like to see options for phasing cluster packages?
- 6) How would you like to consider the overall amount that cluster agencies have requested in this Budget outside of the cluster envelope process?

Other manifesto and cost pressure initiatives

- 40. In their initiative assessments, Treasury Vote teams have explored opportunities for scaling across these manifesto and cost pressure initiatives, and further scaling has been applied in developing the draft package. Consequently, the cost pressure and manifesto sub-packages have been scaled by approximately 60% from what was submitted by Ministers.
- 41. You may wish to consider further scaling or deferring initiatives beyond what has been presented in the draft package. While further reductions are possible, the savings are

not likely to be significant, and could create risks of service failure or the Government not delivering on all of its commitments in this term.

42. If you would like to further refine the packages, we recommend using the Value for Money (VfM) rating as a prioritisation tool by scaling or deferring those initiatives with lower VfM ratings. You could also consider the workforce implications of the initiatives and how these are spread across the package to deliver your key initiatives.

Cost pressures

43. Of the \$1.6 billion per annum in cost pressure initiatives submitted by Ministers, we have recommended providing approximately \$1 billion in funding for genuinely critical and non-deferrable cost pressures e.g. for Public and Transitional Housing [33] million per annum) and for the Disability Support Services cost pressure [33] million per annum). As such, we consider there is minimal benefit to be found in further scaling cost pressures.
44. If there is a desire to further scale the cost pressure sub-package, one area you could explore is not funding initiatives seeking to meet the costs of implementing regulatory or legislative changes that have already been agreed (approximately \$40 million across the forecast period). Typically, agencies are expected to seek funding at the time that the regulatory change is agreed. Removing these initiatives from the package could help reinforce the expectation that implementation costs are sought in tandem with policy decisions. However, this could also create a risk to the effective implementation of these significant regulatory changes.

Manifesto

45. Ministers have sought [33] per annum for manifesto commitments outside the Budget 2022 priority areas. This has been scaled to \$0.9 billion per annum in the draft package. There are further opportunities to consider scaling or deferring significant manifesto initiatives. As part of this you will need to consider the trade-off between fiscal savings and achieving the Government's goals for this term.
46. You also have choices around funding manifesto initiatives through this Budget or through Budget 2023. You may also wish to further scale or defer the larger manifesto initiatives (either in terms of \$ or FTE's) to help ease pressures on Budget 2022 allowances. These should be considered with respect to the large manifesto initiatives we have already excluded from the draft package.

Table 6: Significant manifesto initiatives

Included in draft Package			Not included in draft Package		
Title	(\$ b p.a)	FTE*	Title	(\$ b p.a)	FTE
Establishment of a social insurance scheme	[33], [37], [38]				-
Auckland Light Rail: Progressing the next phase of project delivery					-
Manatu Taonga Strong Public Media	0.09	-	Digital Inclusion in Social Housing Initiative	0.12	-
Supporting the reset and redesign of the emergency housing system	0.09	-	Supporting a Thriving Māori Media Sector – ensuring long-term sustainability and a fuller range of Māori media content	0.05	-
Total	0.4	[33]	Total	1.81	-

*FTE includes contractors

Key question for discussion at Budget Matters:

- 7) When reviewing Annex 2, are there any additional initiatives you would like to defer or scale from the draft package?

Climate Emergency Response Fund

47. We recommend [33] billion in operating expenditure and [33] billion in capital expenditure, for a total proposed Budget 2022 CERF package of [33] billion, excluding the International Climate Finance commitment already charged against the CERF.
48. The package includes funding for all key emitting sectors, including:
- Transport: [33] billion
 - Agriculture: [33] billion
 - Energy: [33] billion
 - Forestry: [33] billion

Table 7: Draft Budget 2022 CERF package

	\$billion multi-year total	
CERF	4.5	
	Operating	Capital
Existing charge - International Climate Finance	0.8	-
Proposed Budget 2022 CERF package	[33]	
Total		
Remaining CERF	1.9	

49. Given the multi-year design of the CERF, we have constructed the package so that it contains high value initiatives that are currently implementation ready, and foundational initiatives that facilitate future climate policy.
50. More detailed advice on the CERF package is also contained in the bilateral briefing for your meeting with Minister for Climate Change on Tuesday 15 February. A parallel process is also underway to support Climate CEs to provide advice to you on a CERF package that will support the emerging Emissions Reduction Plan. We have been working collaboratively with an inter-agency working group (led by the Ministry for the Environment) to support this process.

Other levers for managing within allowances

Review existing tagged contingencies

51. Budget allowances are a 'net' concept, which means additional new spending can be offset by savings or additional revenue.
52. A significant amount of funding is held in [33] tagged contingencies established through Budgets 2020 and 2021 (and precommitted against Budget 2022). In addition, significant funding is held in [33] other tagged contingencies established out of cycle (for example through the CRRF) or prior to Budget 2020.

Table 8: Funding held in tagged contingency at HYEPU 2021 (\$b)²

[33]

53. In many instances it is appropriate to set funding aside in a tagged contingency through the Budget process in order to provide certainty, which may be necessary for work on a particular policy or project (or negotiation) to progress. However, as most tagged contingencies are counted against allowances (or the CRRF) when established, and included in fiscal forecasts, the opportunity cost of holding funding in a tagged contingency is high, especially for periods of time that extend across Budget years.
54. Given the pressure on your Budget allowances, as well as the length of time some funding has been held in contingency, you may wish to explore options for the reprioritisation of tagged contingency funding.
55. Many of your largest tagged contingencies relate to costs where there is likely to be little or no opportunity for reprioritisation (e.g. pay equity settlements, collective employment negotiations, and funding for DHBs). However, there are a number of smaller contingencies where you may have greater discretion for reprioritisation.
56. We have not yet done work to identify where you may have the most discretion to reprioritise tagged contingency funding, so we are unable to provide the options available to you at present, or the quantum of funding that may be involved. Should you wish to explore this further, we are able to provide further advice on the choices available to you ahead of your Budget 2022 decisions.

Workforce Constraint

57. To manage the allocation of workforce into your key priority areas for Budget 2022 we recommended you consider implementing a workforce constraint to aid prioritisation. A suggested range for this constraint could be approximately 3500-4000 FTE and contractors. This workforce constraint is consistent with the average growth rate in the public sector and represents a more realistic approximation of what the current labour market could deliver compared with what agencies sought.
58. Table 9 below breaks down the quantum of FTE and top skills sought across the package for workforce initiatives. Please note these figures are as at Friday February 11, and we are currently undertaking a quality review exercise to ensure the quality and accuracy of workforce information.

² Information on tagged contingencies was last reconciled ahead of the *Half Year Economic and Fiscal Update 2021*, so actual funding held in contingency may differ due to recent drawdowns. Figures include pay equity tagged contingencies (~\$3.6 billion operating total across the forecast period).

Table 9: Workforce composition of the draft Budget package

	Policy	IT Specialists	Other ³	Total FTE
Education	-	19	163	182
Cost Pressure	159	59	362	580
Manifesto	141	47	298	487
CERF	97	33	48	178
Total⁴	397	158	872	1426

59. We will provide a further breakdown of workforce numbers in an upcoming report to support your discussion with the Minister for the Public Service on workforce planning. We will also provide workforce analysis for Budget Ministers 3 slides.

Multi-year funding

Impact of current Budget package on future allowances

60. Through Budget 2022, you are introducing multi-year funding arrangements for the health sector, and the Natural Resources and Justice clusters. Alongside the key benefit of expected improvements in long-term planning, the fiscal impact of multi-year funding will also be spread across the allowances of multiple Budgets.
61. As outlined in Table 10 below, the draft Budget 2022 package would lead to up to a third of the \$4.0 billion operating allowance for Budget 2023 being precommitted for funding for health and the two clusters.

Table 10: Impact of multi-year funding

	B23 (\$b)	B24 (\$b)	B25 (\$b)
Operating allowances	4.0	3.0	3.0
Health	1.3	-	-
Clusters ⁵	0.4	0.4	-
Remaining allowances	2.3	2.6	3.0

62. As part of their assessments, Vote teams have also recommended deferring a number of initiatives that are high value but not time critical. While this will help you form a draft Budget 2022 package that fits within allowances, this will put pressure on Budget 2023.

³ Comprises of other occupations and professionals as per PSC guidelines .

⁴ The workforce numbers do not include health workforce figures as these have not been submitted by the Ministry of Health. Treasury expects there to be a significant amount of workforce numbers required to deliver the health investments.

⁵ This assumes equal phasing across allowances. Options for the phasing of cluster initiatives are discussed elsewhere in this report.

Risks

63. There are a number of outstanding decisions and movements occurring during the drafting of this report which mean the numbers presented in this report will change. The numbers are accurate as at Friday 11 February 2022.
64. You should be aware of some of the upcoming risks which will impact the development of the Budget 2022 package, including:
 - a. **BEFU forecasts increasing Vote Health cost pressure costings** – The Vote Health cost pressure numbers could change following BEFU forecasts. You will receive the preliminary forecasts next week and we will provide you with further advice on the impact of BEFU on the health costs once these have been confirmed.

⁶ Excludes uninvited initiatives expected to be resubmitted at Budget 2023.

- b. **Income pre-commitments** – In March, we understand there will be a Cabinet paper seeking a pre-commitment of \$0.09 billion per annum for Child Support Pass-on. We consider this is one of the lower value for money initiatives in the income support package. If this is to be funded we would recommend this should replace another income support initiative rather than being included as an additional, extra initiative.
- c. **Depreciation Charges** – Depreciation charges, as a result of revaluations, are being sought through a few sectors in this Budget, namely clusters and education. In the cluster process these charges must be managed within envelopes and the clusters must prioritise these against other initiatives. For education, we understand Minister Hipkins will be seeking a Cabinet decision by March on the fiscal treatment of the \$0.2 billion per annum cost for depreciation funding for the school property portfolio after revaluation of assets. You will receive further advice on this issue separately.

Capital

- 65. \$8.6 billion capital investment has been submitted for consideration in Budget 2022 (including pre-commitments). Treasury’s draft package has scaled this down to \$6.7 billion, the majority of which is made up of Health Capital.
- 66. The largest capital initiatives included in the draft package are:
 - [33] billion in the Health portfolio for the initiative “Capital for Sector Infrastructure”
 - \$166.3 million in the Arts, Culture and Heritage portfolio for the initiative “Te Papa Tongarewa – Replacement Facility for Spirit Collection Area”
- 67. The key constraints when considering capital investment are market capacity to deliver and a lack of implementation-ready initiatives, rather than fiscal pressure on the multi-year capital allowance (which is not oversubscribed in the draft package but is front-loaded).

Health capital

- 68. You have more scope to deliver on significant reforms to the health system with capital investments than with operating. There is capacity in the capital allowance to fund further major health projects. However, you may wish to retain some flexibility to deal with unexpected costs as more information becomes known about the consolidated health system asset base over the two-year transitional period. You should also consider the operating costs associated with capital investment (including staffing), particularly in the context of more serious ongoing affordability challenges in relation to Budget operating allowances.

69. Planning maturity for capital projects in the system (both at DHB and Ministry level) is low, but we have seen recent improvements to strengthen the investment pipeline for nationally significant infrastructure investments over the last 12 months. In terms of options for scaling or deferring, the story on the health capital side is the same as for health operating – we recommend funding the cost pressures for the existing health infrastructure portfolio. There is scope for deferring health capital projects in the early development stage, but it gets more challenging to defer capital projects in the delivery stage.
70. The largest health capital initiative is the “Capital for Sector Infrastructure” seeking \$1.7 billion over the next two financial years. The funding is intended to cover over \$0.6 billion of estimated cost pressures across committed infrastructure projects. The proposed envelope would also support existing commitments to proceed to investment (including [33] for the Nelson Hospital redevelopment), while providing contingency for as-yet-unknown risks that may arise over the next two financial years. The level of contingency for as-yet-unknown risks needs to be balanced with any additional new investments in high-priority capital projects. Final sign-off of infrastructure investments is subject to approval by joint Minister or Health New Zealand, noting that future delegations to Health New Zealand are yet to be decided.
71. Budget 2022 capital for Vote Health is being discussed at a Joint Ministers meeting on Monday 7 March 2022 alongside advice on future settings for the health capital system. The Treasury will provide further advice ahead of this meeting.

Investment Panel system-level advice

72. While the Treasury’s draft package is based on Vote team assessments, which are focussed on portfolio-level assessments of initiatives against the value for money and wellbeing criteria set for Budget 2022, the Investment Panel has provided you system-level advice on capital investment. On some initiatives, the Vote team and Investment Panel may have come to a different recommendation, reflecting the two different perspectives.
73. Given the achievability challenges facing all initiatives, the Investment Panel has recommended that deferring funding decisions to future Budgets or until the Cabinet approval of relevant Business Cases. For initiatives that you may wish to fund, the Panel recommends funding business cases rather than funding the investment in full now. For data, digital and cyber security investments, the Panel recommends you focus on foundational investments that will enable future initiatives. In the climate space, the Panel recommends you focus on strategic investments that result in the highest reduction of greenhouse gas emissions.
74. If you are particularly worried about capacity issues in the capital space, you could put more weighting on the Investment Panel’s recommendations, which place an increased emphasis on deliverability.

Annex of initiatives

75. The initiative spreadsheet (Annex 2) provides a full spreadsheet list of all initiatives, including initiatives not included in the Treasury draft package. For each initiative the following information is provided: the level of funding and workforce numbers sought, the value for money ratings, and the level of funding included in the draft package.
76. We ask that you go through this annex and indicate which initiatives you would like to include or exclude from the draft Budget package, or where you may want further advice.

Next steps

77. We will discuss this report with you at the Budget Matters Meeting on Monday 14 February.
78. You and the Associate Minister of Finance (Hon Dr Megan Woods) are also meeting with a number of key spending Ministers from 14 February 2022 to discuss their priorities for Budget 2022 investment.
79. Following these meetings and your feedback on the strategic choices detailed in this report, the Treasury can refine the draft Budget 2022 package ahead of providing you with draft Budget Ministers 3 slides on Friday 18 February.

BUDGET MATTERS

Monday 14 February 2022, 8:30am-9:00am
EW7.6 and Zoom

A G E N D A

- 1. Introduction to the Budget Management team (5 minutes)**
 - a. *Objective:* To introduce you to the Budget Management team (most of whom will join the meeting virtually).

- 2. Budget 2022 – draft package advice (15 minutes)**
 - a. *Objective:* To discuss the key strategic choices you have around forming the draft Budget 2022 package.
 - b. *Attachment:* T2022/6 Treasury Report: Budget 2022 – Options for draft package.

- 3. Approach to Budget Ministers 3 (5 minutes)**
 - a. *Objective:* To confirm your preferred approach to Budget Ministers 3, including the key decisions and points of discussion for the meeting.
 - b. *Attachment:* T2022/6 Treasury Report: Budget 2022 – Options for draft package.

- 4. Queries on other Budget-related advice**
 - a. *Objective:* To discuss any queries you have on the other key pieces of Budget-related advice you have received.
 - b. *Attachments:*
 - T2022/76 Treasury Report: Investment Panel Advice – Budget 2022
 - T2022/117 Treasury Report: Budget 2022 Bilateral: Hon Chris Hipkins (Education and COVID-19 Response Portfolios)
 - T2022/163 Treasury Report: Budget 2022 Bilateral: Hon James Shaw (Climate Change)
 - T2022/215 Treasury Report: Budget 2022 Health Bilateral: Emerging Health Transitional Package