The Treasury

Budget 2024 Information Release

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Budget Ministers 1

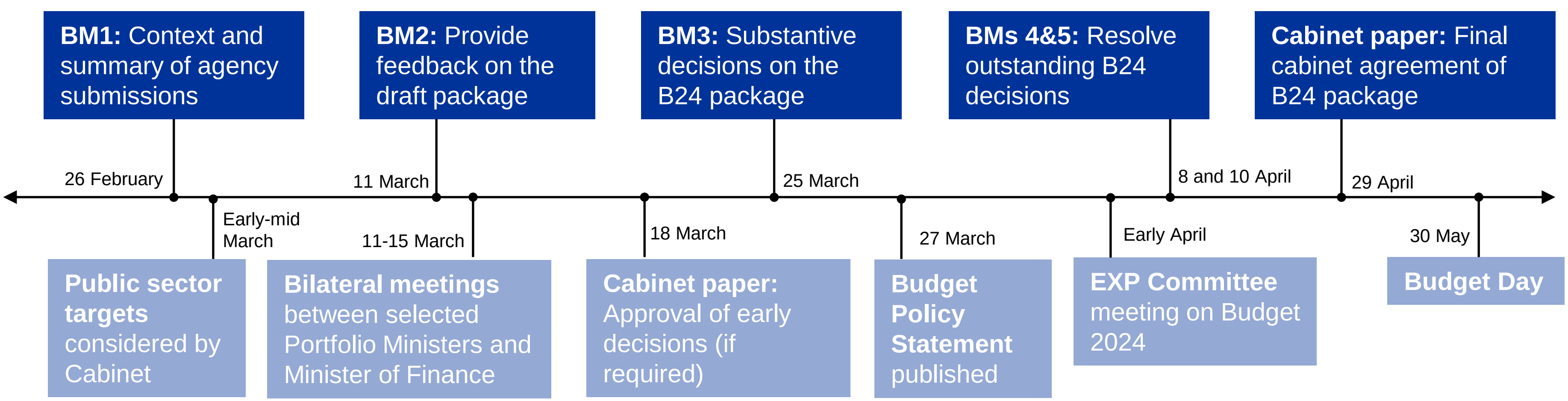
Budget 2024: Strategic outlook and overview of Minister submissions

26 February 2024

Role of Budget Ministers

In December 2023, Cabinet agreed to a Budget 2024 strategy that demonstrates strict fiscal discipline, delivers tax relief and ensures our resources are directed towards the highest value investments to achieve our Government's priorities. Alongside completion of our 100-day plan, work towards delivery of our coalition agreements, and the setting of targets for public service delivery, **Budget 2024 is a key lever for us to continue working towards our coalition priorities.**

Budget Ministers meetings are the key forum for us to collectively decide on the Budget package, which I will then seek Cabinet's agreement to in late April. We will meet fortnightly between now and late April to develop and finalise the Budget package.



Purpose of this meeting

The key objectives for this first Budget Ministers meeting are to:

1. Discuss the **economic and fiscal context** for Budget 2024
2. Provide an overview of **Budget 2024 spending and savings submissions**
3. Discuss our **priorities for, and trade-offs that will be central to, the Budget 2024 package** across cost pressures, funding for government priorities, savings and capital investment.

Key messages

The net fiscal impact of agency submissions (including baseline and targeted savings) **exceeds the remaining budget operating allowance by $4.0 billion per annum.** This shortfall is increasing over time – in 2027/28, it is $5.7 billion. Capital funding sought exceeds the current multi-year capital allowance (MYCA) (not including a $7 billion increase that I intend to seek Cabinet agreement to) by **$20.8 billon over the forecast period**.

Treasury is working intensively to complete its assessment of over 400 agency submissions and will provide me with advice on which savings are realisable and sustainable, and which new funding sought represents good value-for-money. **The funding recommended by Treasury will be significantly lower than that sought by agencies and Ministers.**

That said, it is already clear that Budget 2024 is going to involve compromises and difficult trade-offs between key elements of the Government's priorities, including balancing our policy and fiscal objectives. This group will have to make a set of **interrelated choices** about:

- Which **commitments in our coalition agreements** require new funding at Budget 2024, and which can be met through reprioritisation or future Budgets.
- Which urgent and critical **cost pressures** impacting critical frontline services and major infrastructure projects we prioritise for additional funding.
- To what extent we want to find **savings by stopping and scaling existing programmes** and services (and managing the associated trade-offs) to fund the above.

Budget 2024 is the first of our three Budgets. We will have to make difficult calls about what we prioritise *now*, and what we defer to the future.

Economic Outlook, Fiscal Outlook and Fiscal Strategy

Economic outlook

As outlined in HYEFU, the economy is slowing in response to higher interest rates. **Recent data confirms that this is occurring sooner than previously expected**.

Near-term activity is expected to be softer than anticipated at HYEFU, reflecting weaker housing market activity that has surprised on the downside. Higher interest rates are working their way through the economy and are having a counteracting impact to record net migration.

Inflationary pressure in the December quarter eased largely in line with HYEFU forecasts. Combined with GDP data, this suggests that interest rates could begin to fall slightly earlier.

Recent revisions to GDP mean the NZ economy is not as large as previously thought and **Treasury expects that annual tax revenue will be adjusted down from HYEFU, in the magnitude of low billions rather than millions.** The changing economic outlook will have a large bearing on tax revenue forecasts, although final tax policy changes will also influence these forecasts.

Fiscal outlook

With a weaker labour market, interest rates easing earlier, and lower nominal GDP expected, **there is likely to be a downward revision to the forecast for core Crown tax revenue compared to the 2023 HYEFU forecasts.**

At this stage it is unclear how the weaker economic outlook may impact core Crown expenses. For example:

- While the indexation of benefit payments may be lower from the weaker outlook, recipient numbers may be higher; and
- While a lower interest rate track would reduce finance costs, additional borrowing may be required to cover the shortfall in tax revenue, which would push up finance costs.

The Treasury's updated preliminary fiscal forecasts are not due to be completed until 18 March. However, based on weaker economic growth, it is likely that **both the operating balance before gains and losses (OBEGAL) and net debt tracks will be weaker than previously expected.**

Fiscal strategy

The Government is required to specify its fiscal strategy, including objectives for the operating balance and debt, in the Budget Policy Statement (BPS) on 27 March. Our Budget operating and capital allowances are a key lever for delivering our fiscal strategy.

I intend to discuss **our fiscal strategy and Budget allowances at Budget Ministers 2** on 11 March, once I have received further advice from the Treasury.

Decisions on our fiscal strategy and Budget allowances come in the context of current structural operating deficits, elevated inflation and global economic headwinds that will continue to challenge the fiscal position over the forecast period.

The HYEFU showed a return to a $140 million surplus in 2026/27 and $3.4 billion in 2027/28. Given the downward revision to Crown revenue, **achieving an OBEGAL surplus in these years will likely require more fiscal consolidation than previously expected.**

Overview of Budget 2024 Submissions

Budget 2024 – funding sought

Agency submissions exceed the remaining **operating allowance by $4.0 billion (average per annum).** This shortfall is increasing over time – in 2026/27, it is $5.7 billion per annum. Not factoring in an increase to the multi-year capital allowance (MYCA) of $7 billion that I intend to seek Cabinet agreement to, capital submissions also exceed **MYCA by $20.8 billon total**.

Budget 2024 Department Submissions		Operating Allowance						Multi-Year Capital Allowance
$millions | Savings / (Spending)	**Per Annum**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28 and Outyears**	**Total Operating**	**Total Capital**
Budget 2024 Allowances	**3,500**	**-**	**3,500**	**3,500**	**3,500**	**3,500**	**14,000**	**2,900**
Precommitments at HYEFU	(2,442)	(121)	(2,301)	(2,482)	(2,600)	(2,263)	(9,768)	120
Mini Budget decisions	1,867	228	1,153	2,501	2,112	1,475	7,470	455
Expected Pharmac precommitment	(445)	-	(445)	(445)	(445)	(445)	(1,782)	-
Remaining Unallocated Allowances	**2,480**	**107**	**1,907**	**3,074**	**2,567**	**2,267**	**9,921**	**3,475**
Spending, Revenue and Savings against allowances as at 22 February 2024								
Savings and Revenue	**2,195**	**321**	**1,726**	**2,130**	**2,231**	**2,372**	**8,781**	**1,396**
New Spending *(includes tax package)*	**(6,394)**	**(122)**	**(4,547)**	**(5,773)**	**(7,015)**	**(8,118)**	**(25,575)**	**(23,754)**
Cost Pressures and Capital Cost Escalations	**(2,278)**	**(51)**	**(2,143)**	**(2,324)**	**(2,353)**	**(2,241)**	**(9,113)**	**(1,961)**
Total Budget Submissions	**(6,477)**	**148**	**(4,964)**	**(5,968)**	**(7,136)**	**(7,986)**	**(25,907)**	**(24,320)**
Under / (Over) Budget Allowances	**(3,996)**	**254**	**(3,057)**	**(2,894)**	**(4,570)**	**(5,720)**	**(15,986)**	**(20,845)**

Note that:

- Pre-commitments do not currently include $1.5 billion total operating for repeal of amendments to the Smokefree Environments and Regulated Products Act 1990 and regulations. This will create additional headroom in the allowance.
- [33] and [38]
- The targeted policy savings include estimated savings from the policy changes to pay equity settlements.
- Ministers have agreed that funding remaining in the National Resilience Plan (NRP) will be returned to the centre. The above table does not reflect this decision, as such when funding is returned to the operating and capital allowances this will provide additional headroom.

New spending on Government coalition priorities

$25.6 billion total operating and $23.8 billion total capital of new spending has been submitted by agencies. Treasury is currently assessing these submissions and **expects there to be scaling options for most initiatives**. That said, it is clear **there will be insufficient room within the Budget 2024 allowances to fund the full set of Government commitments.** Of the new spending, summarised below are the key coalition Government priorities invited into the Budget process. This includes significant time-limited funding.

Education

- Ka Ora, Ka Ako | Healthy School Lunches Programme [33]
- Internet in Schools, Equipment Replacement and Cyber Security [33] **$69m capital**
- Continued Teacher Supply Supports [33]
- Partnership Schools [33]
- Apprenticeship Boost Scheme Continuation [33]
- Te Pukenga Disestablishment and Transition [33]
- Structured Approaches to Literacy
- Further Teacher Professional Learning and Development (PLD) **$63m operating**

Health

- Timely access to COVID-19 vaccine and therapeutics and ongoing cost-effective management of COVID-19 [33]
- Increasing access to medicines including cancer treatments [33]

[33]

- Breast screening extension of eligibility to include 70–74-year-olds **$28m operating, $7m capital**
- Gumboot Friday **$24m operating**
- Waikato New Medical School – cost benefit analysis and business case development **$5m operating**
- Mental Health and Addiction Community Sector Innovation Fund **$21m operating**

[33]

- Training 50 more doctors **$20m operating, $26m capital**
- Emergency department security - service expansion [33]

Law and Order

- Corrections Rehabilitation Programmes - Extending to Remand Prisoners [33]
- Taking a tougher approach to sentencing **$4m operating, $0.9m capital**
- Responding to gang harm [33] **$0.2m capital**
- Investing in Core Policing [33]
- Addressing Serious Youth Offending [33]
- Fast Track Youth Offending Programme [33]

Tax

Family Boost [33]

Personal Income Tax [33]

In work tax credits [33]

Interest Deductibility [33]

Online gambling [33]

Infrastructure

- Government Policy Statement on Land Transport 2024 [33]
- North Island Weather Events Road Response, Recovery and Rebuild [33]
- Continued Recovery from the North Island Weather Events [33]
- Regional Infrastructure Fund Establishment [33]
- Funding for Kanoa to support the Regional Infrastructure Fund and previous interventions [33]
- National Infrastructure Agency Establishment [33]
- Resource Management Reforms – Replacement [33]
- Implementing Local Water Done Well [33]
- Civil Aviation Authority Liquidity Funding [33]

Other

- Welfare that Works – Youth focused Employment Support [33]
- New Zealand Screen Production Rebate – International [33]

[33]

- GeoNet and the National Seismic Hazard Model [33]
- Kāinga Ora Crown-Funded Programmes and Statutory Obligations **$50m operating**
- Independent inquiry into how the COVID-19 pandemic was handled in New Zealand [33]
- DPMC - establishment of Delivery Unit function [33]
- Ministry of Regulation – Establishment and ongoing funding [33] **$2m capital**
- Historic Claims of Abuse in Care [33]

Notes. Numbers are total over the forecast period. Grey highlighted initiatives are related to time limited funding.

Further information on the tax package

Fiscal impact of the tax package

Policy	Total Costings Submitted	Estimated alternative costings for options
	$millions | Revenue / (Spending)	
Agreed at Mini Budget		
Brightline Test Adjustment	(180)	(180)
Removing commercial building depreciation	2,311	2,311
Remaining Policies to agree		
Personal Income Tax adjustment (incl. IETC)	(13,724)	(8, 313 - 10,141)
Interest deductibility	(2,920)	(2,735 – 2,920)
Family boost	(741)	(741)
$25 pw IWTC adjustment	(621)	(621)
IRD compliance activity*	1,012	1,012
Online gambling taxation changes**	190	146 – 190
[33]		
Net total fiscal impact of the tax package	[33]	

* This return on investment submitted by Inland Revenue has not been scrutinised yet.
** IR submitted the higher of the revenue estimates for online gambling taxation changes which would require an accompanying licensing regime. Not reflected in this submission is any departmental costs for DIA to establish a regulatory regime as they have not submitted a bid for this policy as invited. If no regulatory regime is progressed the net revenue from this policy will be $146 million over forecast.

The **fiscal impact of the tax package is expected to be between** [33] Note this is lower than the figures submitted to Treasury by Inland Revenue, who used the highest estimate for each policy in their Budget submissions.

There are key opportunities for us to reduce costs in these two areas, providing headroom to fund other priorities:

- **Personal Income Tax adjustments, including Independent Earner Tax Credit changes:** minor changes to parameters or timing of adjustment could result in significant cost reductions, bringing the total cost down from $10.1 billion to $8.3 billion.
- **Interest deductibility:** Total costs **$2.7 and $2.9 billion to restore interest deductibility**. This cost depends on the rate it is phased back in.

Cabinet agreed to commission the Minister for Revenue to develop targeted revenue options to partially offset the cost of the tax package. I am following up with him regarding this.

Cost pressures – Urgent & Critical

$9.1 billion of total operating cost pressures and capital cost escalations have been sought by agencies. This is higher than expected, although this likely partially reflects that agencies ordinarily submit the highest cost option (with scaling and phasing presented in their submission templates).

Up-side risks include:

- [33] and [38]
- The Department of Corrections has sought [33] operating over the forecast period for volume pressures.
- NZDF has also sought [33] over forecast for remuneration pressures, as well as other, uninvited (i.e., non-remuneration) pressures.

Treasury is assessing these submissions now, and I have instructed them to provide options regarding how these submissions could be scaled, re-phased or met through reprioritisation. I will report back to Budget Ministers on this work at BM2.

Agencies have also provided information about how they intend to manage uninvited cost pressures from within existing and/or reduced baselines, which Treasury will provide advice on. I will report back to Budget Ministers on these assessments.

However, it is already clear that **Budget 2024 will involve difficult trade-offs between protecting frontline services in a high inflation environment, and our other priorities (e.g., new spending, tax).**

Baseline savings

$1.4 billion (operating per annum) of baseline savings have been submitted by portfolio Ministers. This is **below the target of $1.5 billion** (operating per annum).

Most agencies have met their targets, but I am following up with several Portfolio Ministers who have not done so. Importantly, several of the agencies that have not met their targets are the largest dollar-value contributors.

A high-level analysis of submitted savings proposals indicates that several savings proposals identified by agencies and supported by Ministers:

- May not be realisable because of their alignment with **the Government's priorities** in the affected portfolio.
- Do not come from agency baselines and are therefore not eligible.
- May **not materialise by 2024/25.**
- May not flow through **to OBEGAL** in the way envisaged by agencies (e.g., due to Treasury's top-down adjustment).
- Have significant FTE implications.

At BM2, I will present to Budget Ministers an overview of Treasury's assessment of baseline savings proposals. This will include:

- Seeking consensus about which savings are unacceptable or unfeasible.
- Where this is the case, whether to require the Portfolio Minister to present alternative proposals.

I have also asked Treasury to provide me with advice on whether agencies have taken a consistent approach to, for example, reducing back-office and contractor and consultant expenditure.

It will be vital that we continue to set and enforce clear expectations regarding portfolio Ministers meeting their targets with high quality, feasible proposals. **In the meantime, we should not assume that all $1.4 billion of the current baseline savings proposals will be included in the final package.**

Targeted savings and revenue

$3.4 billion total operating of targeted savings and revenue options have been submitted by portfolio Ministers. Treasury is currently assessing these proposals, including whether these proposals (many of which are complex) can feasibly be realised and whether they will materialise by 2024/25 or future years.

I have also commissioned further advice on:

- **Potential further savings in Vote Social Development**, particularly in areas where there are levers to target support across the system [33]
- [33]
- Further savings that could be realised from examining **the level of FTE attached to individual policy programmes** in large votes.
- Returning funding held in **tagged contingencies** to the centre, to be reprioritised for other Budget 2024 priorities. This will happen through Treasury's March Baseline Update (MBU) process.

The quantum of savings that the above processes will realise is **uncertain and difficult to quantify.** I will report back to this group regarding these options at BM3 on 25 March.

Targeted savings and revenue options

A summary of the targeted savings and revenue submitted by agencies is set out below.

Vote	Title	Total operating ($m over forecast)
Agriculture, Biosecurity, Fisheries and Food Safety	Agricultural Emissions Pricing – Return of Tagged Contingency	14.7
Business, Science and Innovation	Energy Efficiency and Conservation Authority – return of funding (including Warmer Kiwi Home)	178.5
Business, Science and Innovation and Conservation	Conservation and Tourism and Hospitality Portfolios – International Visitor Levy	[33]
Environment	Environment Targeted Savings - Waste Disposal Levy	101.8
Health	Prescription co-payment – reinstating the $5 prescription co-payment with targeted exemptions	116.1
Health	Disestablishment of the Maori Health Authority – return of funding	35.5
Internal Affairs	Savings from the repeal of the Three Waters programme	[33] and [37]
Justice	End of the mana orite relationship as mutually agreed between the Justice Sector Leadership Board and Inaia Tonu Nei.	6.0
Justice	Victims of Crime – Improving Outcomes Initiative – Return of funding	[33]
Labour Market	Immigration Crown savings - removing Crown funding provided for visa subsidies	97.9
Labour Market	Immigration Crown savings – Charging users for more of the cost of services	469.5
Labour Market	Regional Skills Leadership Groups—Disestablishment and return of funding	45.9
[33]		
Social Development	Emergency Housing: Tightening the gateway and scaled down support services for people in emergency housing	[33]
[33]		
Tertiary Education	Workforce Development Councils Disestablishment	[33]
Tertiary Education	Fees Free – Replacing First-Year with Final-Year Fees Free	399.0
Tertiary Education	Increasing the Student Loan Scheme overseas interest formula by 1% for 5 years	5.0
	Total	[33]

[38]

Capital investment

$24.3 billion net total capital over forecast period has been submitted. Capital funding sought exceeds the current multi-year capital allowance (MYCA) by **$20.8 billion over the forecast period.**

There is currently $3.5 billion remaining in the Multi-Year Capital Allowances (MYCA). This does not include the $7 billion increase that I intend to seek Cabinet agreement to, and the return of the National Resilience Plan.

The largest new capital investments and cost escalations submissions over the forecast period by vote are:

- [33]
-
- **Business, Science and Innovation ($1.2 billion)** for the Regional Investment Fund establishment.
- [33]
-
-
-

All capital funding sought will also have associated operating implications.

Budget 2024 - Department Submitted	Multi-Year Capital Allowance
$millions | Savings / (Spending)	**Total Capital**
Budget 2024 Allowances	**2,900**
Precommitments at HYEFU	120
Mini Budget decisions	455
Remaining Unallocated Allowances	**3,475**
Summary of Capital related initiatives	
Savings and Revenue	1,396
New Spending - Capital	(23,754)
Capital Cost Escalations and Cost pressures	(1,961)
Total Budget Submissions	**(24,320)**
Under / (Over) Budget Allowances	**(20,845)**

Capital investment – strategy

Significant scaling of the capital funding sought will be required:

- I have agreed to seek Cabinet's agreement to increase the MYCA by up to $7 billion, from the current balance of $3.5 billion. However, given the significant amount that has been submitted as well as market capacity, we will need to target our investment decisions through Budget 2024.
- The capital initiatives submitted are also seeking a significant amount of associated operating. Given the pressure on the operating allowance, we will need to factor this into decisions on capital investments.
- The five large, capital-intensive agencies* all have substantive reviews or investment plans underway this year.

We have an early opportunity to set a strategic direction for the capital elements of Budget 2024 package to assist with package formation in the coming weeks. This could include:

- Setting expectations that agencies first consider reprioritising within existing capital funding to offset requested funding.
- Prioritising urgent cost pressures and funding for critical assets at risk of immediate failure or delivery delay.
- Selecting a small number (i.e., 1-2) of Government priority areas for investment at Budget 2024.
- Awaiting the outcome of the above reviews before taking significant investment decisions, to also ensure Cabinet has visibility of these broader funding needs and relative priority across the pipeline.

**Transport (pre-Budget), Housing (March), Education (May), Defence (June),* [33]

Pre-commitments and late invitations

The funding sought by agencies makes clear that there is **significant pressure on the Budget 2024 allowance.** To minimise further pressure, it is vital that there is a robust, cross-Cabinet effort to:

- **Minimise further pre-commitments on the allowance.** To give us the opportunity to make a full suite of trade-offs through Budget 2024, the threshold for pre-commitments should be very high. Unless there are unavoidable and significant operational risks for delay, and there are no viable reprioritisation options available, decisions on funding our commitments should be made as part of Budget 2024.
  - I <u>do not</u> recommend any further funding at Budget 2024 for agencies to meet the Government's public sector targets.
- **Minimise late and uninvited invitations into the process.** I have instructed Treasury not to assess uninvited submissions. It will be vital that we mitigate further invitations.

Next steps

The next Budget Ministers meeting is on 11 March. **The key objective of this meeting will be for Budget Ministers to provide feedback and direction on the draft package.**

The material for this meeting will include a recommendation and comment from the Treasury on each initiative, including whether to fund, not fund, scale, or defer.

As part of this, I will also present the Treasury's initial value-for-money analysis on submitted initiatives:

- Advice regarding how submissions **align** with Government and Budget 2024 priorities, the **costs** and **benefits** of submissions, the **deliverability** of proposals, and their **distributional** impacts.
- Potential legislative, climate, workforce (i.e., FTE implications of savings and new spending) and Treaty of Waitangi implications of initiatives.

I will also provide an oral update to the **Cabinet Expenditure and Regulatory Review Committee (EXP)** regarding this material tomorrow (27 February).