The Treasury

Budget 2024 Information Release

September 2024

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[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

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[36] 9(2)(h) - to maintain legal professional privilege

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[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Budget 2024 Strategy and Design

Date:	1 December 2023	**Report No:**	T2023/1953
		File Number:	BM-2-1-2024

Action Sought

	Action Sought	**Deadline**
Minister of Finance (Hon Nicola Willis)	Indicate whether to change Budget allowances at the Mini Budget Agree to the proposed Budget 2024 strategy, including core design elements Indicate which initiatives you want to invite into the Budget 2024 process Agree to take a paper to Cabinet on 11 December seeking decisions on the Mini Budget, the Government's fiscal strategy and Budget 2024 strategy	4 December 2023

Contact for Telephone Discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
Emily Fulford	Senior Analyst, Budget	[39]	[35]	✓
Stephen Bond	Manager, Budget			
Stacey Wymer	Director, Budget			
Struan Little	Deputy Secretary, Budget and Public Services			

Minister of Finance's Office Actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report	

Enclosure: Yes

Executive Summary

The annual Budget process is the key mechanism for the Government to set its fiscal objectives, allocate funding and resources consistent with its priorities, and seek Parliamentary authority for spending. The process commences with the Minister of Finance seeking Cabinet's agreement to the overall Budget strategy.

Setting the core elements of your wider Budget 2024 strategy before Christmas alongside your Mini Budget will set clear expectations on how the Budget process will ensure Ministers and agencies are focused on preparing sufficient savings. We have prepared a draft paper seeking Cabinet's agreement on 11 December to the Budget 2024 strategy, alongside decisions on the core elements of the Government's fiscal strategy and Mini Budget.

There are various options for setting your Budget strategy ranging from targeted and directive to broad and bottom up. To be consistent with your fiscal objectives and given the tight timeframes within which the Budget will need to be developed, we recommend that you opt for the former strategy. As part of this approach, we recommend that you implement an Initial Baseline Exercise through Budget 2024, which would be the first phase of a Fiscal Sustainability Programme.

This exercise would be focused on:

- seeking information from agencies on a range of issues that portfolio and Budget Ministers will want to consider in understanding agency baselines, identifying savings and setting future expenditure plans against performance expectations
- setting an aggregate savings target that gives Budget Ministers options on where to extract savings from
- inviting select Government policy commitments to be submitted, which are focused on top priority commitments, and addressing the end of urgent time limited funding
- inviting a strictly limited set of urgent, critical cost pressures to be submitted, where it is demonstrated they cannot be met within baselines without significant trade-offs, and
- directing agencies to outline their plans for reprioritisation and managing unfunded cost pressures.

In this report we are seeking your decisions on the design of the savings target (after which we will provide further advice on the precise quantum), and which initiatives you would like to invite for submission into the Budget process. Following Cabinet's approval, we recommend that you communicate these decisions in letters to portfolio Ministers.

The previous Government established several discrete funds that operate outside the core Budget allowance framework, and approved multi-year funding for several sectors. You have choices about whether to continue with these for Budget 2024.

You also have choices about whether to change the size of the operating allowance and multi-year capital allowance (MYCA) at the Half Year Economic and Fiscal Update. You could choose to reduce the Budget 2025-2027 operating allowances at the Mini Budget per National's Fiscal Plan. However, we recommend that you keep the Budget 2024 operating allowance at $3.5 billion and the MYCA at $2.9 billion at the Mini Budget and make a decision on the size of these allowances at the Budget Policy Statement or through the Budget 2024 decision-making phase.

Recommended Action

We recommend that you:

a **note** the Budget process commences with the Minister of Finance and Budget Ministers determining the overall strategy they want to set for the upcoming Budget and seeking Cabinet's agreement

b **agree** to take a paper to Cabinet on 11 December seeking decisions on the Mini Budget, the core elements of the Government's fiscal strategy and Budget 2024 strategy

Agree/disagree.

Budget allowances

c **agree** to either:

Option A: Reduce the operating allowances at the Mini Budget to $3.2 billion in Budget 2024, $2.85 billion in Budget 2025 and $2.7 billion in Budgets 2026 and 2027

Agree/disagree.

OR

Option B: Reduce the Budget 2025-2027 operating allowances at the Mini Budget per Option A but keep the Budget 2024 operating allowance at $3.5 billion and make a decision on reducing it as part of the Budget Policy Statement or Budget 2024 decision-making

Agree/disagree.

OR

Option C: Keep the Budget 2024-2027 operating allowances unchanged at the Mini Budget (as per the operating allowances at PREFU) and make a decision on reducing them as part of the Budget Policy Statement or Budget 2024 decision-making

Agree/disagree.

d **agree** to keep the multi-year capital allowance at $2.9 billion at the Mini Budget and make adjustments as part of the Budget Policy Statement or Budget 2024 decision-making

Agree/disagree.

Overall Budget 2024 strategy

e **agree** that the overall approach to Budget 2024 is targeted and directive, focused on savings, select Government policy commitments and strictly urgent and critical cost pressures that cannot be met within baselines

Agree/disagree.

f **agree** to publish a Budget Policy Statement in March 2024

Agree/disagree.

g **provide** feedback on the draft Budget 2024 priorities outlined below:

- *Addressing the rising cost of living*: deliver meaningful tax relief to working New Zealanders through changes to the tax system and cancellations of existing and planned taxes.
- *Delivering effective and fiscally sustainable public services*: introduce measures to improve value for money by focusing on results (in particular, in health, education, and law and order), and responsibly manage public finances.
- *Building for growth*: deliver more housing, infrastructure and renewable energy through reprioritisation, regulatory change that creates the conditions for investment, and developing a long-term pipeline of investments.
- *Enabling private enterprise*: improve regulatory settings to encourage skills growth, innovation, and competition, and to attract investment and boost exports.

Budget design

h **agree** to implement an Initial Baseline Exercise (IBE) through Budget 2024 as the first phase of implementing a Fiscal Sustainability Programme

Agree/disagree.

i **agree** to set an aggregate operating savings target, specifying the minimum quantum of savings which agencies will need to identify options to meet through the IBE

Agree/disagree.

j **note** that we have developed an initial range of $3 – $4 billion per annum of savings that would need to be identified, and that we will seek your agreement to the final savings target following your decisions on what Government policy commitments and cost pressures you want to invite into the Budget 2024 process

k **note** you are receiving separate advice on the more detailed design elements for a baseline reduction and how an overall savings target could be allocated across agencies [T2023/1996]

l **indicate** in the following annexes which initiatives you want to invite portfolio Ministers and agencies to submit into the Budget 2024 process**:**

- Annex A: the Government's policy commitments, including which (if any) you want a social investment approach applied to in Budget 2024.
- Annex B: critical cost pressures
- Annex C: Treasury identified targeted policy savings (over $100 million)

m **agree** that as part of the Initial Baseline Exercise portfolio Ministers and agencies are required to outline their plans for reprioritisation and managing unfunded cost pressures

Agree/disagree.

n **note** that you are receiving separate advice on capital investment, including reviewing the investment pipeline for Budget 2024

Discrete funds and multi-year funding

o **note** that you will receive advice in early December on Health sector cost pressures and multi-year funding arrangements

p **agree** that the Justice and Natural Resources Clusters are included within the IBE, which will also require them to identify savings from 2024/25

Agree/disagree.

Next steps

q **note** you will receive a draft Cabinet paper on 4 December

r **note** that the Treasury will provide you with another draft of the Cabinet paper on 5 December, and subject to incorporation of your feedback and direction, will lodge a final paper on your behalf on 8 December, and

s **refer** this report to the Prime Minister, and Associate Ministers of Finance Hon Chris Bishop, Hon David Seymour and Hon Shane Jones.

Refer/not referred.

Stephen Bond
Manager, Budget

Hon Nicola Willis
Minister of Finance

_____/_____/_______

Treasury Report: Budget 2024 Strategy and Design

Purpose of Report

1. This report seeks the key decisions required before Christmas on the strategy for Budget 2024.

Context

Overview of the Budget process

2. The annual Budget process is the key mechanism for the Government to set its fiscal objectives, allocate funding and resources consistent with its priorities, and seek Parliamentary authority for spending.

3. The process commences with the Minister of Finance and Budget Ministers determining the overall strategy they want to set for the upcoming Budget. Key inputs in setting the strategy include:

    - the wider fiscal and economic context
    - what the Government wants to achieve from both a fiscal and policy perspective
    - the amount of new funding the Government wants to allocate on top of existing expenditure as well as savings, reprioritisation or revenue raising options to create additional fiscal headroom, and
    - what the process practically looks like, including the approach used to develop the Budget and specifying expectations of agencies and portfolio Ministers.

4. The Minister of Finance usually seeks Cabinet's agreement to the final Budget strategy in the latter half of the calendar year to ensure there is collective buy-in to, and understanding of, the process. The Budget Policy Statement (required under the Public Finance Act 1989) then publicly communicates (before 31 March) the broad parameters in which Budget decisions will be made, including the fiscal rules and the Government's priorities for the Budget.

5. The remainder of the process is focused on:

    - agencies developing initiatives on behalf of their Ministers
    - the Treasury assessing initiatives and providing advice to Budget Ministers on a draft Budget package, including the key trade-offs and risks
    - Cabinet approving the final Budget package (typically in May), and
    - the Government communicating its Budget decisions to the public and seeking Parliament's authority to spend.

We recommend that you set your Budget 2024 strategy before Christmas

6. While the Government's immediate focus and priority is delivering a Mini Budget in December, we recommend that you set the core elements of your wider Budget 2024 strategy before Christmas. This timing provides both the opportunity to communicate clear and immediate expectations around expenditure constraint and fiscal discipline, and also gives the maximum time for agencies to develop high-quality savings proposals and invited new spending initiatives for submission on behalf of their portfolio Ministers in early February.

7. You have lodged a Cabinet paper for consideration on 4 December, which recommends that Cabinet invites you to report back on 11 December on:

   - core elements of a fiscal sustainability programme to restore discipline to government spending
   - the financial recommendations for 100-Day Plan decisions taken since 28 November and other time-critical decisions as required, and
   - Budget 2024 strategy consistent with the proposed fiscal sustainability programme

8. This report reflects the advice that we have provided in the following material:

   - Initial decisions for your fiscal strategy [T2023/1992]
   - Implementing the fiscal strategy [T2023/1987], and
   - Mini Budget and Budget 2024: Critical early decisions slidepack.

9. You are also receiving the following advice:

   - Delivering headroom and allocating Baseline Reductions [T2023/1996]
   - Advice on time-limited funding [T2023/2026], and
   - Capital Investment: context and critical early decisions [T2023/1967].

Budget allowances

10. You have received advice on the following fiscal strategy [T2023/1992 refers]:

    - to return the Operating Balance before Gains and Losses (OBEGAL) to surplus in 2026/27 at the latest and deliver this forecast trajectory at the Budget and Economic Forecast Update 2024
    - to achieve a 1% of GDP surplus no later than 2027/28, to be forecast by BEFU 2024 at the latest, and
    - deliver a Mini Budget that is at least fiscally neutral in every year of the forecast period.

You now have choices regarding your Budget allowances…

11. One of the core components of the fiscal management approach are operating and capital allowances. These are the pools of new funding (on top of existing baseline expenditure) for new policy initiatives, cost increases in existing policy, and capital investment. They form a self-imposed cap on expenditure growth and are set in advance of the Budget in accordance with the Government's fiscal strategy. The operating allowance is an annual allocation while the capital allowance is a multi-year allocation over the next four Budgets.

12. Allowances are a net concept as spending increases and any revenue reductions can be offset by savings initiatives or revenue raising initiatives. The Budget process is the key mechanism to allocate funding in allowances. Funding can be pre-committed against allowances in advance of the Budget process, however, this limits Ministers' opportunities to make trade-offs across the Government's priorities.

13. The table below outlines the current operating allowance and multi-year capital allowance (MYCA) and how much remains unallocated following existing pre-commitments.

14. The funding pre-committed against the Budget 2024 operating allowance at PREFU largely consists of cost pressures for health (multi-year funding cost pressure track), education (collective bargaining settlements and forecast demand changes), transport (revised draft Government Policy Statement 2024 on Land Transport) and the Justice and Natural Resources Clusters established by the previous Government. You can decide prior to, or during, the Budget process whether you want to unwind any of these pre-commitments.

Table 1: Overview of operating and multi-year capital allowances

Operating allowance ($m)	**Budget 24**	**Budget 25**	**Budget 26**	**Budget 27**
PREFU allowances	3,500	3,250	3,000	3,000
Pre-committed at PREFU (incl. health cost pressure track)	(2,223)	(1,370)	(1,370)	(1,370)
Education forecast change	(147)	-	-	-
Remaining unallocated allowances	**1,130**	**1,880**	**1,630**	**1,630**
Multi-year capital allowance ($m)	**Budgets 2024-2027**			
PREFU allowances	2,935			
Pre-commitments following PREFU[1]	763			
Remaining unallocated allowances	2,172			

We recommend retaining the current Budget 2024 operating allowance for now

15. In National's Fiscal Plan, you proposed reducing operating allowances to $3.2 billion in Budget 2024, $2.85 billion in Budget 2025 and $2.7 billion in Budgets 2026 and 2027. You have a choice about whether to make these reductions in the Mini Budget, through the Budget Policy Statement or during the decision-making phase of Budget 2024.

16. You could reduce the Budget 2025-2027 operating allowances at the Mini Budget as there is still a reasonable portion of allowances remaining for allocation. As part of this the Government would need to signal how these reductions would be achieved, which could be done through setting a clear Fiscal Sustainability Programme in the new year. Changing these allowances at the Mini Budget, would mean doing so before the Government agrees the specifics of its fiscal strategy.

17. While a number of significant cost pressures are covered by existing pre-commitments against the Budget 2024 operating allowance, there is minimal funding remaining to cover the Government's policy commitments, other critical cost pressures and time-limited funding. As such there are risks (in addition to benefits) with reducing the Budget 2024 operating allowance prior to making savings and spending decisions.

[1] These cover $750 million for an in-principle agreement for Crown support for Kiwi Rail's Inter-island Resilient Connection (iReX) project, and $13 million for strengthening and fitout works for Bowen House.

18. A reduction at the Mini Budget would reinforce the Government's commitment to fiscal discipline and help increase the size of the forecast surplus. However, it could restrict your choices at Budget 2024 if some of the trade-offs associated with savings options are not palatable.

19. In addition, you have committed to a significant amount of savings to fund planned tax cuts at Budget 2024. Therefore, even a $3.5 billion allowance means a significant savings programme. Further reductions to that allowance would make the savings needed by Budget 2024 even larger.

20. On balance, we recommend that you do not make any changes to the Budget 2024 operating allowance now and instead consider any reductions as part of the Budget Policy Statement or Budget decision-making process. This approach minimises the risk of needing to increase the Budget 2024 allowances later, and allows decisions on allowances to be informed by the level of savings and new spending you want to progress at Budget 2024.

We recommend retaining the current multi-year capital allowance for now

21. As outlined in table 1 above there is currently $2.2 billion remaining in the multi-year capital allowance which is for allocation over the next four Budgets (subject to decisions on iReX).

22. You now have a choice about whether you increase the size of the MYCA at the Mini Budget. In HYEFU 2023 the forecast year will extend to 2027/28 compared to 2026/27 at PREFU. You could choose to increase the MYCA by $7 billion (as per the National's Fiscal Plan) to reflect the additional forecast year. However, we recommend that the MYCA is not topped up with additional funding for the following reasons:

- there are market capacity constraints for the current pipeline and additional investment will create further pressure
- the Government's priority of fiscal discipline
- the potentially significant operating funding implications associated with capital investments, particularly when operating allowances are already constrained for Budget 2024, and
- we are recommending a review of the capital investment pipeline, which may free up some existing funding (further information on this review is below).

23. We recommend you make a decision on the size of the MYCA at the BPS or during the Budget 2024 decision-making process. This can including take into account the Government's commitment to establish a Regional Investment Fund.

Overall Budget 2024 strategy

We recommend that the overall Budget 2024 strategy is targeted and directive

24. There are various options for setting your Budget strategy ranging from targeted and directive to broad and bottom up. To be consistent with your fiscal objectives and given the tight timeframes within which the Budget will need to be developed, we recommend that you opt for the former strategy. We recommend that Budget 2024 is focused on savings, select Government policy commitments and strictly urgent and critical cost pressures that cannot be met within baselines.

25. This approach allows you to run the following model:

- **Centralised** (December) – Budget Ministers decide which new spending proposals to invite for submission into the Budget process and provide portfolio Ministers and agencies with an overall savings target that needs to be met.

- **Decentralised** (January-February) – portfolio Ministers work with their agencies to develop initiatives and savings proposals based on what has been invited.

- **Centralised** (February-April) – the Treasury assesses agency submissions and advises on a draft package, the Minister of Finance has Budget bilateral meetings with portfolio Ministers, and Budget Ministers make funding and savings decisions and recommend a final Budget package for Cabinet's approval.

26. We have recommended you establish a Fiscal Sustainability Programme [T2023/1987 refers]. You have indicated to Cabinet that you will seek their agreement on 11 December to establish a programme focusing on:

- generating sufficient reprioritisation, savings, and revenue raising measures to fund our priorities and deliver enduring improvements in the OBEGAL position

- strengthening the public finance system to tighten fiscal discipline and embed a culture of continuously improving value for money, and

- ensuring collective ownership and accountability for the fiscal position and value for money at all levels of government.

27. The Budget 2024 strategy and process is a critical first step of implementing this programme, and will set the tone for future Budgets.

We recommend setting Budget 2024 priorities prior to Christmas

28. As outlined above, the Government is required under the Public Finance Act to produce a Budget Policy Statement (BPS) that sets out its priorities for the coming Budget; the overarching policy goals that will guide its decision-making; and the longer-term wellbeing objectives the Government wants to make progress against.

29. To help set clear expectations and frame the overall Budget package, we recommend that Cabinet agrees its priorities for Budget 2024 prior to Christmas. Drawing on the Government's policy commitments, the Treasury has drafted a set of proposed Budget 2024 priorities for your consideration, which we welcome your feedback on.

- *Addressing the rising cost of living*: deliver meaningful tax relief to working New Zealanders through changes to the tax system and cancellations of existing and planned taxes.

- *Delivering effective and fiscally sustainable public services*: introduce measures to improve value for money by focusing on results (in particular, in health, education, and law and order), and responsibly manage public finances.

- *Building for growth*: deliver more housing, infrastructure and renewable energy through reprioritisation, regulatory change that creates the conditions for investment, and developing a long-term pipeline of investments.

- *Enabling private enterprise*: improve regulatory settings to encourage skills growth, innovation, and competition, and to attract investment and boost exports.

30. We recommend setting your overarching goals and wellbeing objectives in the new year, as part of the process of developing the BPS. While the legislation sets some requirements, there is discretion about the specific objectives and priorities you set, including how they align with the Government's goals.

31. If you agree with this timing, we will provide initial advice to Budget Ministers in January with the aim of having them agreed by mid-late February, for full publication of the BPS in March. It is a requirement of the Public Finance Act that the Government explain in the Fiscal Strategy Report how wellbeing objectives have guided Budget decisions. Our recommended approach would provide more time to set your objectives and goals given their more enduring nature, while also ensuring that they are agreed in time to inform the assessment of initiatives and the development of the Budget package.

Budget design

32. While there are core elements embedded into the Budget process, each Budget differs based on the priorities of the Government and the broader fiscal environment. For Budget 2024, we recommend that you run an Initial Baseline Exercise, which enables trade-offs to be made in a single process across savings and new spending. Framing Budget 2024 as an Initial Baseline Exercise also sets clear expectations for agencies that it is a savings orientated process that will reorient government to focus on strong fiscal discipline and sustainable, well-planned spending across the public sector.

33. This exercise would be the first phase of the Fiscal Sustainability Programme (FSP) that we recommend establishing as part of implementing your fiscal strategy [T2023/1987 refers]. The information provided by agencies in this exercise would not only support Budget 2024 decision-making but also the next phase of the FSP post-Budget 2024, including savings and performance plans. You will receive further advice on these proposed plans the week of 4 December.

34. The Initial Baseline Exercise would seek information from agencies on a range of issues that portfolio and Budget Ministers will want to consider in understanding agency baselines, identifying savings and setting future expenditure plans, such as, historic expenditure, cost trends, risks and information on performance. It will also seek specific information on the following three components covering both operating and capital expenditure:

- savings
- invited new spending (Government policy commitments and critical cost pressures), and
- reprioritisation.

35. When considering the Initial Baseline Exercise, it will be important to ensure that decisions with respect to each component are aligned with your Budget priorities and longer-term objectives.

We recommend setting a single target for agencies to develop savings options

36. Limited fiscal headroom within allowances means considerable savings need to be returned to the centre to achieve the Government's fiscal strategy, deliver a fiscally neutral Mini Budget and fund the Government's policy commitments and critical cost pressures. This will be a significant and challenging exercise and is likely to involve substantial policy decisions to achieve.

37. To meet these objectives, we recommend providing agencies with a single target for the quantum of operating savings options they must identify, which encompasses the components in table 2 below.

Table 2: Components of an aggregate operating savings target

Type	Purpose	Quantum (per annum)	Basis of the quantum
1) Existing baseline savings	To help achieve the fiscal strategy	$500 million	Based on the number the previous Government booked at PREFU 2023.
2) Baseline reduction	To help offset the cost of tax plans, achieve the fiscal strategy and supplement Budget allowances to fund the Government's other policy commitments and critical cost pressures	$1 billion	Based on the "bureaucracy savings" and "contractor savings" in National's Fiscal Plan.
3) Headroom savings		$1 – $2 billion	Based on our current assessment of cost pressures, time-limited funding, and Government policy commitments that you may need to fund at Budget 2024. Your decisions on scaling or phasing of these would change this number.
4) Savings buffer	To enable Ministers to impose higher or lower savings on different agencies so that there are greater choices on where to find savings	$500 million	In the 2011 efficiency savings process, there was a buffer of approximately 20% ($50 million per annum). We suggest for Budget 2024 that the buffer is a lower proportion but still at a level that provides Ministers with options.

38. At this stage we have developed a range of $3 – $4 billion per annum of savings that would need to be identified. This savings target is in addition to specific policy savings that the Government has already committed to but includes your proposed reductions to departmental expenditure (including contractor & consultant expenditure).

39. However, you have options for managing this quantum down:

- **Upfront options to reduce the aggregate target that is provided to agencies pre-Christmas:** inviting fewer Government policy commitments into Budget 2024; choosing additional significant targeted policy savings (from the Treasury identified list) to deliver before Christmas; not inviting some of the time-limited funding into the Budget process (and funding these through reprioritisation); and not inviting any additional cost pressures for submission (apart from the existing health cost pressure track).

- **Options to reduce the final savings quantum agreed during the Budget decision-making process:** inviting work on some larger targeted policy savings options (from the Treasury identified list) and revenue raising initiatives for consideration in the Budget 2024 process; and making decisions to scale or defer some of the initiatives you do invite.

40. Regardless of the specific target that is set, we propose it includes a buffer so that Budget Ministers have options on where to extract savings from (i.e. in case Budget Ministers choose to make trade-offs and take less savings from one agency this would need to be offset by greater savings from another agency).

41. The intention is that agencies would work with their portfolio Ministers through the Initial Baseline Exercise to identify efficiencies, programmes not aligned with Government priorities and lower value spending to meet this savings target. Through the decision-making phase of the Budget, Budget Ministers and Cabinet would agree the final amount of savings to take from each agency. Any savings that Cabinet does not use to meet the objectives in paragraph 36 above, could be used by agencies for internal reprioritisation towards higher priority and higher value activities.

42. You are receiving separate advice on the more detailed design elements of setting a savings target and how targets get allocated across agencies [T2023/1996 refers]. We will also seek your agreement to the final savings target (and allocation across agencies) following your decisions on what Government policy commitments, cost pressures and time-limited funding you want to invite into the Budget 2024 process.

We recommend that you undertake a review of the capital investment pipeline

43. We recommend you initiate a review to reprioritise and sequence the capital investment pipeline [T2023/1967 refers]. This is to ensure that the pipeline is aligned with the Government's priorities, is better matched with agency, market and fiscal capacity, and reflects a continued focus on value for money. For Budget 2024, we recommend identifying savings opportunities for projects already in delivery, as well as reviewing unfunded investments that are in planning.

44. We have reviewed the pipeline of investments in planning and delivery and identified investments that we have assessed as suitable for reprioritisation. We will be seeking your agreement to commission agencies on the full list of investments for Cabinet to review as part of the Budget process (those that are funded and will deliver savings) and beyond Budget 2024 (those that are unfunded and will be seeking funding in future budget years). Agencies will be commissioned to provide a strategic assessment to evidence the need for Government intervention and alignment against Government priorities, as well as key information from the Budget evaluation framework.

45. Since Budget 2020, the Treasury has convened a panel of senior representatives from system and functional leaders to evaluate investments invited to Budget (the "Investment Panel"). The Investment Panel provides advice on specific investments and system-wide insights drawing on their commercial expertise and view across the portfolio and market, to support you and Cabinet in making evidence-based investment decisions at Budget. We will continue to use the Panel for Budget 2024 and the pipeline review with a focus on reviewing investments for reprioritisation and savings.

We recommend that you invite select Government policy commitments for Budget 2024

46. The Government has an ambitious policy programme, which will require sequencing and phasing over the next three Budgets. For Budget 2024, we recommend that you only invite select Government policy commitments for submission for both operating and capital, which are focused on time critical commitments, and addressing time limited funding that expires in 2023/24.

47. In Annex A, we are seeking your indication of which initiatives you would like to invite for submission into the Budget process. This will allow portfolio Ministers and agencies to provide a more detailed proposal and cost breakdown as part of their Budget submissions in in the new year, for you to consider funding at Budget 2024.

48. When considering which commitments to invite for Budget 2024 it may be helpful to use principles to guide your decisions, we recommend you consider:

- **Sequencing** – inviting only a proportion of commitments for Budget 2024, to manage agency expectations of funding and focus their effort on developing initiatives on the highest priority areas.

- **Delivery** – whether to focus on quicker to deliver initiatives or beginning work on more complex commitments that will need further policy work and take longer to have an impact.

49. You have options about how you want to approach social investment, including through Budget 2024. [33]

50. If you choose to include the approach this Budget, we recommend you focus on a small number of initiatives selected from the Government's policy commitments. We will provide further advice on how to use evidence and evaluation to inform the design and delivery of these initiatives through the Budget process. If there are particular initiatives you consider to be amendable to social investment, we will work with agencies in the design and assessment stage to ensure these initiatives are presented in accordance with your social investment objectives. We recommend this approach rather than a specific social investment track.

We recommend that urgent and critical operating cost pressures are invited by exception only

51. Agencies face the following cost drivers, which generally result in pressures as the cost of delivering existing services increase:

- **Volume**: costs arising from changes in population growth, population characteristics, or the economic environment. These are client-driven and include pressures arising from a reduction in third-party revenue.

- **Personnel and wage**: these include pressures associated with bargaining and remuneration outcomes and/or due to wage progression.

- **Price**: these include changes in the costs of inputs (e.g. as a result of inflation), changes in capital related operating expenditure due to increases in the value of assets and cost escalations for capital projects that are currently in delivery.

52. Agency baselines do not automatically adjust for these factors, which means agencies need to manage cost pressures through reprioritisation or seek additional funding through the Budget process. As cost pressures are funded through allowances, they are traded off against other new spending. This means the Government needs to strike a balance between maintaining core public services and achieving their broader policy goals. Where cost pressures are genuine and are not funded, over time it can lead to the degradation of services and create a larger funding gap to be dealt with in later Budgets.

53. Various approaches have been taken to managing these pressures within the Budget process over time. Previous examples range from enforcing fixed baselines with a high bar for any additional cost pressure funding through the Budget process to agencies seeking cost pressure funding with no top-down constraint. More recently agencies have been provided with envelopes to prioritise key cost pressures within.

54. Given the fiscal context and constrained allowances, we recommend taking a more targeted approach for Budget 2024. The default would be no additional funding for cost pressures and that agencies manage these through reprioritisation or taking active choices to stop or scale programmes and services. There would then be a "by exception" process, where only urgent, critical and significant cost pressures for a small number of agencies are invited for submission. We also recommend that significant cost escalations for capital investments, which are predominantly in the capital-intensive areas (e.g. transport, health, housing, defence), are assessed as part of the capital pipeline review discussed above.

55. This ensures a holistic approach is taken to savings and cost pressures, so that agencies are not simply seeking funding to rebuild their baseline following returning savings to the centre. However, it is important to note that cost pressures do not automatically go away so a more targeted approach will have potentially significant implications for agencies.

56. We have considered the priority areas for the Government and used these to inform the minimum and maximum level of cost pressures you could invite into the Budget process. The minimum option is targeted to the critical cost pressures for the key priority areas of the Government (i.e. health and education). The maximum option is focused on a slightly wider set of services (i.e. Corrections, Police, Justice, Defence, Oranga Tamariki and Whaikaha) that are a priority for the Government or where there very limited options to manage within existing funding.

57. When considering which option to adopt, it is important to note that while a less targeted approach provides greater options during the decision-making process, it potentially runs counter to overall expectations of fiscal discipline. We recommend on balance that you proceed with the minimum (i.e. "narrow and targeted") option. However, we also recommend that you consider additionally inviting Whaikaha volume and price pressures for submission. Whaikaha's services are akin to health services where there are limited levers in the short term to manage demand, particularly due to the devolved nature of Disability Support Services. Inviting agencies to submit cost pressures would not be a guarantee of funding.

58. In Budget 2023, several agencies received additional funding to meet the costs of the Public Sector Pay Adjustment where they had a collective employment agreement that expired in 2022 or expiring in 2023. A number of agencies had agreements expiring outside this period, most notably the Ministry of Business, Innovation and Employment and the Ministry for Primary Industries. We recommend that for agencies in this position that remuneration cost pressures are met through reprioritisation.

59. To set clear expectations, we suggest signalling that the approach to providing additional funding for cost pressures will be targeted across the term. This will help shift incentives on agencies to consider options to address underlying cost drivers rather than managing through one tight Budget and coming back with pressures the next Budget.

We recommend asking portfolio Ministers and agencies to outline their plans for reprioritisation

60. Given the quantum of savings that will need to be identified and the targeted approach to new spending, most agencies will need to undertake significant reprioritisation to manage within a reduced baseline, including meeting unfunded cost pressures.

61. You have choices about what level of visibility Budget Ministers receive on agencies' reprioritisation plans during the decision-making process. We recommend that agencies outline their plans for reprioritisation and managing unfunded cost pressures through the Initial Baseline Exercise.

62. This ensures that Budget Ministers are aware of the biggest trade-offs and the key service delivery risks have been highlighted. This allows Budget Ministers to determine if and where trade-offs are not palatable and therefore, additional funding may be required in limited circumstances. It also would provide a starting point for the Savings and Performance Plans that we are recommending the Government introduce as part of the Fiscal Sustainability Programme [T2023/1987 refers].

Discrete funds and multi-year funding

63. The previous Government established several discrete funds that operate outside the core allowance framework, and approved multi-year funding for several sectors. These measures are aimed at enabling longer-term approaches to address complex cross-sectoral problems and incentivise agencies to plan and prioritise better by providing certainty of funding. However, they reduce Cabinet's flexibility to allocate funding to the highest priority areas each Budget in a way that may be difficult to justify in a fiscally constrained environment where tough choices will be required of all sectors. You have choices about whether to continue with these discrete funds and multi-year funding.

You will receive advice on multi-year funding for the Health sector

64. As part of the Health sector reforms, Te Whatu Ora – Health New Zealand and Te Aka Whai Ora – the Māori Health Authority were provided with a two-year funding package at Budget 2022. The next phase of the reforms is to move to three-year funding from Budget 2024. A cost pressure funding track for these agencies has already been nominally allocated against the Budget 2024-2026 operating allowances.

65. The Government will need to decide whether to continue with the multi-year funding approach for the Health sector for Budget 2024 or revert to standard annual funding. You will receive initial advice from the Treasury in early December on Health sector cost pressures and multi-year funding.

We recommend requiring the Justice and Natural Resources Clusters to identify savings

66. In 2021, the previous Government agreed to a three-year pilot of two multi-agency budgeting "clusters": a Justice Cluster and a Natural Resources Cluster (NRC)[2]. The pilot was intended to deliver three objectives: longer-term financial planning; improved performance reporting; and (for Justice) inter-agency collaboration.

[2] The Justice Cluster includes the Ministry of Justice, Department of Corrections, Police, Crown Law and Serious Fraud Office. The Natural Resources Cluster includes the Ministry for the Environment, the Ministry for Primary Industries and Department of Conservation.

67. In Budget 2022, these clusters received a total of $3.8 billion additional upfront funding for Budgets 2022-2024. The original intention was that the cluster agencies would not seek additional funding in Budgets 2023 and 2024 (apart from where an agreed exception had been granted), and that a decision would be made ahead of Budget 2025 on whether to continue with either cluster going forward. It was also agreed that for the baseline savings booked at PREFU 2023, cluster agencies would not need to find savings until 2025/26 (as opposed to 2024/25 for other agencies).

68. [33] . However, in the short term you need to decide how to treat the clusters in the Budget 2024 process, including savings. While including clusters in Budget 2024 could have implications for the future of the pilot, we recommend that cluster agencies are required to identify savings through the Initial Baseline Exercise from 2024/25 so that the Government has greater choices on where to find savings. As with other agencies, you will have options in the decision-making phase of the Budget process on how much these savings are returned to the centre vs used by agencies to fund cost pressures and Government policy commitments.

69. If you agree that cluster agencies are part of the Initial Baseline Exercise, we recommend that they are treated the same as non-cluster agencies for the purposes of invitation into the Budget process (i.e. they can be considered for invitation to submit Government policy commitment initiatives and critical cost pressures).

Approach to analysis

We recommend focusing assessment of Budget initiatives on value for money

70. Value for money is about delivering the best results from limited spending. A key role for the Treasury in the Budget process is assessing new spending and savings proposals to determine whether they offer value for money and to help inform Budget Ministers' decision-making. Given the current fiscal context, investing in initiatives which use quality evidence, have a robust intervention logic, and deliver the highest value for money will be important.

71. We propose that assessment is focused on value for money according to the following five criteria: **alignment** with the Government's priorities for Budget 2024 and longer-term objectives; the weighing up of **benefits** and **costs**; the **deliverability** of the initiative; and the **equitable** distribution of impacts. Judgement and transparent assumptions are required to assess each of these components individually and collectively. Using this approach will ensure that Treasury can systematically assess the quality of submitted initiatives to best inform Ministerial decision-making.

72. Our analysis will also include interrogating the workforce implications of submitted initiatives, particularly where additional resourcing is sought, so that Ministers can determine where limited resources should be prioritised.

73. In previous Budgets, there have been pilots to undertake more concerted distributional analysis, such as, for gender budgeting. Given the tight timeframes for this Budget, we do not propose undertaking any separate additional analysis and that instead this happens through the value for money approach outlined above.

74. We understand the Ministry for Women will be providing advice to the Minister for Women on options for gender budgeting in Budget 2024, and recommending the Minister discusses these with you. We recommend that you outline the focus is on value for money overall, and that there will not be a separate gender budgeting exercise.

75. Monitoring, evaluation and reporting are an important part of the Budget cycle to ensure effectiveness of public spending and to continuously improve value for money. We recommend that key new spending initiatives be required to have meaningful and appropriate performance indicators, and adequate reporting routines and processes are established early on. We will provide you with further advice on reporting requirements for funded initiatives following Budget decisions.

Timeframes and communications

76. Following Cabinet's approval of the Budget strategy, we recommend that you write to all portfolio Ministers to:

- reinforce your expectations for Budget 2024
- communicate the savings target that each agency will need to meet and which capital investments will be invited into the reprioritisation and sequencing exercise
- invite the Government policy commitments and cost pressure initiatives you want submitted into the Budget process, and
- signal medium-term fiscal sustainability programme activities.

77. We will prepare a draft of these letters for your feedback and approval, based on the decisions taken in this briefing.

78. The Treasury also prepares Budget guidance and templates for agencies, which will be provided to them shortly after the Cabinet's consideration of the Budget strategy. These are an important tool for both ensuring Budget submissions are high quality, and for communicating key messages about the Government's Budget strategy within agencies. We will share a draft of these with your Office for feedback.

79. The table below outlines the high-level indicative timelines for Budget 2024. We will provide you with a more detailed timeline and further advice on the decision-making phase of the Budget process, including confirming whether you would like Budget bilaterals with portfolio Ministers.

Table 3: Indicative Budget 2024 timelines

Date	Key milestone
11 December	Budget 2024 Strategy and Design paper considered by Cabinet
Mid December	Letters sent to portfolio Ministers Budget 2024 guidance and templates for agencies issued
Early February	Initial Baseline Exercise submitted by agencies
Mid-February	Treasury assessment of initiatives
March to early April	Budget Ministers' decision-making and potential bilateral meetings with portfolio Ministers
Mid-April	Budget 2024 package considered by Cabinet

Next steps

80. We have prepared a draft Cabinet paper based on our recommendations in this report. Following your decisions (including on the Mini Budget), we will provide you with a draft on 4 December for your feedback. We will provide you with a final draft on 5 December, and subject to incorporation of your feedback and direction, will lodge a final paper on your behalf on 8 December.

81. The Cabinet paper will also seeks decisions on treatment of the Fiscal Sustainability and Effectiveness Programme (FSEP) established under the previous Government [CPC-23-MIN-0015 refer]. We recommend the proposed fiscal sustainability programme [T2023/1987 refers] replaces the previous FSEP, with all but two components of that previous programme discontinued.

82. The two components we suggest you continue are:

    - The baseline savings, which were reflected centrally in the PREFU forecasts. This will be incorporated into the aggregate savings target delivered through the Budget 2024 Initial Baseline Exercise.

    - The stricter approach to out-of-cycle spending, which requires your approval (as Minister of Finance) for out-of-cycle spending requests to progress to Cabinet. Continuing to utilise these rules will support the scrutiny and fiscal discipline objective of the new proposed fiscal sustainability programme.