

The Treasury

Budget 2024 Information Release

September 2024

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Reference: T2024/895

Date: 3 April 2024

To: Minister of Finance (Hon Nicola Willis)

Deadline: 8.30am, 5 April 2024

Aide Memoire: Briefing on Budget 2024 Defence Package

We understand you are meeting with the Minister of Defence (the Minister) on 5 April 2024 to discuss the Budget package for the New Zealand Defence Force (NZDF). This Aide Memoire provides an overview of the proposed package and key changes since Budget Ministers 3 (BM3) and suggests some potential points to raise in the bilateral.

Summary

The BM3 package included a net increase of \$136.047 million operating and \$216.423 million capital funding over the forecast period for NZDF.

Since BM3, you have requested:

- **An updated savings package to address two concerns raised by the Minister.** One concern will require reducing one of NZDF's savings initiatives by ^[33] over the forecast period compared to the BM3 package. The second concern raised is part of initiative 15545 (Reduction in lower value programmes and activities) which was not included as a savings option in the BM3 package and therefore has no additional cost. As this is the only area of concern within this initiative raised by the Minister, it creates an option to include the rest of the proposed savings from this initiative ^[33] over the forecast period) in the Budget package.
- **Options to include an approximately additional \$50 million per annum operating funding for cost pressures (Remuneration and Depreciation) and new spending (Improving Protection Against Maritime Threats and NH90 Helicopter Upgrade: Navigation and Secure Radios).** The breakdown proposed allocates most of the funding to cost pressures (\$31.903 million per annum for depreciation and an additional ^[33] per annum for remuneration), whilst enabling the two new spending initiatives to be supported in full. We understand that NZDF consider funding for cost pressures as the top priority, and you could consider allocating further funding to cost pressures at the expense of the new spending initiatives.

Depending on the approach taken to savings for initiative 15545, the Budget package for NZDF would be the following:

	(\$m over forecast period)			
	BM3 package		Revised package	
	Operating	Capital	Operating	Capital
Savings	(89.650)	-	(85.250 - [33])	-
Cost pressures	120.000	-	[33]	-
New spending	105.697	216.423	126.580	281.090
Net spending	136.047	216.423	309.702 – 338.942	281.090

Given fiscal constraints, the new funding provided remains below what was sought by NZDF. [33]

Further detail

Updated savings package

The Minister of Defence wrote to you outlining her concerns with the negative impacts resulting from two sub-components within the following savings initiatives:

- 15544 - Non-Operational (Back-office) functions including contractor and consultant savings: The Minister raised concerns regarding [33] NZDF advise that this component totals [33] of savings across the forecast period. Given this savings initiative is included in the package, scaling of [33] is required to address the Minister's concerns.
- 15545 - Reduction in lower value programmes and activities: Savings were proposed from across a range of lower value programmes and activities, including insurance, [33] further reductions in travel, and [33]. The Minister of Defence has only raised concerns regarding the sub-component relating to [33] (NZDF advise this component totals [33] over the forecast period). Given this initiative is not currently included in the package you could either leave the package unchanged (Option A in below table) or include a version of this initiative that removes the component relating to [33] (Option B in below table); Option B would achieve a higher level of savings than the BM3 package and still mitigate the Minister's key concerns by not including the [33] savings.

Savings (\$m over forecast period)	Submitted	BM3	Revised package	
			Option A	Option B
15544 - Non-Operational (Back-office) functions including contractor and consultant savings	(89.650)	(89.650)	[33]	[33]
15545 - New Zealand Defence Force - Reduction in lower value programmes and activities	[33]	-	-	
15546 - Reduction of Infrastructure and Platform Maintenance		-	-	
15547 - Capability Divestment and Reduction		-	-	
Total savings		(89.650)	[33]	

Additional funding for cost pressures and new spending

You requested options to include approximately an additional \$50 million per annum operating funding (and associated capital funding) across four initiatives. We propose the below breakdown, with the majority of the funding being for cost pressures.

We understand that NZDF consider funding for cost pressures as the top priority, and you could test with the Minister the relative importance of further cost pressure funding compared to these new investments. For example, we consider the initiative 'Improving Protection Against Maritime Threats' could feasibly be deferred and further consideration given to club funding ahead of Budget 2025; this could enable the funding to be re-allocated to remuneration.

Additional initiatives	(Operating \$m)		Capital (\$m)
	Forecast period	Average p.a.	Forecast period
<i>Cost pressures</i>			
Depreciation	127.612	31.903	-
Additional remuneration	[33]		-
<i>New spending</i>			
NH90 Helicopter Upgrade: Navigation and Secure Radios	[38]		
Improving Protection Against Maritime Threats			
Total	198.495	49.624	[38]

The implications for NZDF's total cost pressure and new spending package of this breakdown are outlined below.

Cost pressures

[33]

for remuneration, [33] for other uninvited cost pressures).

Following the first bilateral, NZDF presented scaled options to Treasury totalling [33] over the forecast period for all cost pressures (including remuneration) which it considers represents the funding required to “preserve and stabilise the NZDF until the Defence Capability Plan (DCP) is completed to avoid further unplanned reductions in military options”.

We have proposed an updated cost pressure package which prioritises funding for the cost pressures considered the highest priority by NZDF – depreciation and remuneration – whilst remaining within the envelope you outlined.

Cost pressure	Operating (\$m over forecast period)			
	Original submission	Revised submission	BM3 package	Proposed package
Depreciation expense arising from asset revaluation	[33]	127.612	-	127.612
Remuneration		[33]	120.000	[33]
Fuel			-	
Ammunition			-	
Estate Maintenance			-	
Platform Maintenance			-	
Total			120.000	

The unfunded cost pressures appear genuine, however NZDF considers these to be relatively lower priority and it either appears to have greater scope to manage these or impacts are less likely to be felt in the near-term. For example:

- Fuel – whilst prices remain above historic levels, a reduction in prices from recent highs will allow activity levels to increase in 2024/25 without a substantial change in NZDF’s total fuel costs (compared to current financial year). Further, we understand that a lack of personnel, as opposed to fuel costs, continues to be the key constraint on activity levels as a whole and in the operation of some particular platforms.
- Maintenance – Given the savings initiative ‘15546 - Reduction of Infrastructure and Platform Maintenance’ is not included in the package, NZDF will retain some capacity for both planned and unplanned maintenance. This is also considered the relatively lowest priority cost pressure given other cost pressures have a greater near-term impact on outputs.

If the Minister seeks additional funding for cost pressures at your bilateral, we consider this should be at the expense of one or both of the additional new spending initiatives.

Given its appropriation structure, upon receiving cost pressure funding NZDF typically has a high degree of discretion in how that funding is used and can balance its funding across the various cost pressures it faces. For example, underspends resulting from staff vacancies have been used to pay one-off salary payments and offset other cost pressures. Whilst this structure provides benefits to NZDF, it means Treasury has limited visibility of how NZDF allocates its funding. We will engage with NZDF ahead of the Budget 2025 process to obtain more detailed information, although achieving this may require a Ministerial direction.

New spending

In addition to the initiatives included in the BM3 package, we understand the Minister of Defence wishes to seek funding for an additional three new spending initiatives. We understand you have indicated you propose to consider supporting funding for two of these:

- 15505 - NH90 Helicopter Upgrade: Whilst this initiative was not invited into the Budget process¹, there appears to be a good case for investment. This initiative seeks funding to procure and install new navigation and communication equipment on the eight NH90 Helicopters, which provide air mobility for operations and support to other agencies. If the investment is not made, NZDF report that it will become increasingly dangerous to fly the NH-90 helicopters in civil airspace, and failure to update radios will mean Secure Communications capability both with internal NZDF units and partners will continue to be limited (this capability is already reduced²). NZDF also note that unless a time-limited delivery opportunity is utilised, upgrades will not proceed for several years due to market capacity constraints. An Implementation Business Case is reportedly planned for mid-2024, but a draft has not yet been shared. Scaled options may be possible but have not been presented.
- 15508 – Improving Protection Against Maritime Threats: This initiative seeks funding over the forecast period for a computer system that provides a real time picture of what is happening in New Zealand’s maritime domain. This will be operated by the National Maritime Coordination Centre (NMCC), which is currently funded by a combination of baseline funding through Customs and a ‘club share’ arrangement whereby other stakeholder agencies pay an amount based on agreed proportions. Defence note that other agencies may be unable to contribute to support this initiative given the need to find baseline savings, and some agencies have reportedly already withdrawn from the current arrangement.

Whilst there is a case for investment at some point, this would represent a new capability and is therefore likely to be deferrable; you may wish to test with the Minister of Defence the urgency and relative prioritisation of this investment

¹ A business case has not been agreed by Cabinet, though business cases for previous tranches of the programme have been agreed and progressed.

² Partial upgrades to radios were made in March 2023, which were described at the time as allowing the fleet “to be deployed operationally with a functional yet reduced secure communication capability” and that the reduced capability was “acceptable to the RNZAF in the short term”.

compared to cost pressures. It is unlikely to be possible to scale the investment, though the funding could be scaled if a contribution was required from relevant agencies through club funding.

You have indicated you do not wish to support the following initiative:

- [33]

New spending initiatives	(\$m over forecast period)			
	BM3 package		Proposed package	
	Operating	Capital	Operating	Capital
Upgrading ^[1] Digital Services	[38]			
Modernising Devices and Productivity Tools	[38]			
Upgrading the Regional Supply Facility and Logistics Model at Linton Military Camp	[38]			
Homes for Families (Part Two)	7.000	-	7.000	-
Military Operational Vehicles	[38]			
<i>Proposed changes post-BM3</i>				
Improving Protection Against Maritime Threats				
NH90 Helicopter Upgrade: Navigation and Secure Radios				
Total	105.697	216.423	126.580	281.090

³ We understand Defence currently intend to take an Implementation Business Case for Tranche 1 to Cabinet in early 2025, meaning it could be considered as part of the Budget 2025 process.

Where initiatives are subject to the completion and Cabinet approval of business cases, we recommend tagged contingencies are established.

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