

## Treasury Report: Budget 2009: Bilateral for Votes Health and State Services

<b>Date:</b>	13 March 2009	<b>Report No:</b>	
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### Action Sought

	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Bill English)	<b>Read</b> the attached briefing and use it as the basis for taking decisions in your bilateral with Hon Ryall at 9am on 16 March 2009.	16 March 2009
Associate Minister of Finance (Hon Simon Power)	<b>Read</b> the attached briefing and use it as the basis for taking decisions in your bilateral with Hon Ryall at 9am on 16 March 2009.	16 March 2009

### Contact for Telephone Discussion (if required)

<b>Name</b>	<b>Position</b>	<b>Telephone</b>		<b>1st Contact</b>
[deleted – privacy]	Senior Analyst, Health	[deleted – privacy]	[deleted – privacy]	✓
[deleted – privacy]	Analyst, Health	[deleted – privacy]	[deleted – privacy]	
[deleted – privacy]	Senior Analyst, State Sector Performance	[deleted – privacy]	[deleted – privacy]	

### Minister of Finance's Office Actions (if required)

None.
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**Enclosure: No**

## Treasury Report: Bilateral Briefing for Votes Health and State Services

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Attached is a briefing for the bilateral between the Minister of Finance and the Minister of Health and State Services at 9 a.m. on 16 March 2009 to discuss the Budget initiatives for Votes Health and State Services.

The bilateral briefing is structured as follows:

Vote Health	p. 4
Vote State Services	p. 14

Key decisions to be taken are:

### *Vote Health*

- The Vote Health Budget package:
  - The overall size of the Health operating budget package; and
  - The size and source of the health capital allocation;
- Value for money and 3-5 year strategic direction;
  - Follow up to the Line by Line Review and key issues for next 6-12 months;
  - The size of the Budget 2010 indicative Health allocation and whether to roll out an indicative allocation for Budget 2011;
  - Future capital funding arrangements.

### *Vote State Services*

- Vote State Services savings.

### *Vote Health*

#### *Health Budget package*

This report outlines two Health Budget packages for Budget 2009 which provide options as Ministers seek to manage both Health and wider pressures:

- Treasury's preferred option is a Budget package with \$622 million new health spending and a net Operating Allowance (OA) impact of \$543 million.
- An alternative option to meet the Government's \$750 million new health spending commitment on health which has a net OA impact of \$694 million.
- Within each package there are sufficient amounts of one-off funding to manage the highest priority health capital pressures.

Treasury's view is that a capital allocation of \$200 million should be approved to meet the highest priority health capital pressures in Budget 2009, and that this should be entirely funded entirely from one-off operating funding in Vote Health. Ministers will also be able to set aside some additional one-off funding to increase DHB deficit provisioning should deficit forecasts rise.

#### *Value for money and 3-5 year strategic direction for Health*

The key challenge in the next 3-5 years is to make the adjustments required in the Ministry of Health and the Health sector to manage to a significantly lower growth path after a long period of high growth, while securing better health services. This will require a step change in the management of the Vote including in Budget decision-making/arrangements, and in Ministry culture and processes to embed a stronger, ongoing drive for value for money. It will also necessitate significant shifts in core health system and policy settings to increase supply-side efficiency and manage demand more effectively through DHBs. Preparation for these changes needs to get under way with more urgency in the year ahead and be grounded in the fiscal reality.

A number of report backs are recommended to address the key immediate issues and to shift the Ministry's focus:

- creating headroom for Budget 2010 from reprioritisation in Ministry-managed baselines;
- setting an appropriate value for money work programme for the next 6-12 months to get more out of DHBs;
- options for future Health Budget arrangements and Forecast Funding Track and Demographics (price/volume adjuster) in light of the 3-5 year outlook;
- better management of the Health Capital Envelope; and
- overhauling the ownership monitoring regime for DHBs.

#### *Indicative allocations for Health*

Setting Health's indicative allocations should be deferred at least until the Operating Allowance has been set for Budget 2010, or even later to allow for maximum flexibility. Treasury's view is that it would not be prudent to set any indicative allocations at this time due to the current economic uncertainty (i.e. no indicative allocation for Budget 2010 would be announced in Budget 2009). A significantly lower allocation will be required in Budget 2010.

#### Vote State Services

##### *Vote State Services Savings*

Treasury supports the line-by-line review that SSC has undertaken, which provides an effective 10% saving in Departmental baselines. We also support the proposed repositioning of the Commission as a smaller more focussed entity and the associated reduction in headcount.

We believe that the upcoming reduction in functions and headcount should make further saving available in outyears as incremental savings in overhead can be realised, and therefore SSC should be encouraged to identify further savings *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*

*[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].*

## Recommended Action

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We recommend that you **read** the attached briefing and use it as the basis for taking decisions in your bilateral with the Minister of Health and State Services at 9 a.m. on 16 March 2009.

Ruth Isaac  
**for Secretary to the Treasury**

Hon Bill English  
**Minister of Finance**

## Overview of Vote Health

### Minister of Health's submission

1. As part of the Minister of Finance's request to Vote Ministers to carry out a line-by-line review, and submit bids for emergency pressures and policy priorities, the Minister of Health initially submitted an operating package which rose to \$850 million in outyears. The package has since been revised and the Minister of Health is now seeking the following:

	<i>\$million - increase/(decrease)</i>					
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13</i>	<i>Outyears (2023/24)</i>
<i>Operating (GST excl)</i>						
<i>Funding</i>						
Funding sought from OA	-	750.000	750.000	750.000	750.000	750.000
ACC PHAS	-	33.592	33.592	33.592	33.592	33.592
Savings	76.242	34.451	23.963	22.305	22.305	22.305
<b>Total operating funding</b>	<b>76.242</b>	<b>818.043</b>	<b>807.555</b>	<b>805.897</b>	<b>805.897</b>	<b>805.897</b>
<i>Spending</i>						
Emergency pressures	-27.023	590.273	579.318	575.124	578.062	578.062
Policy priorities	1.750	136.393	171.332	181.689	186.716	208.154
<b>Total spending</b>	<b>-25.273</b>	<b>726.666</b>	<b>750.650</b>	<b>756.813</b>	<b>764.778</b>	<b>786.216</b>
<i>Surplus funding</i>						
One-off funding	101.515	71.696	37.224	29.403	21.438	-
Ongoing unallocated funding	-	19.681	19.681	19.681	19.681	19.681
<b>Total surplus operating funding</b>	<b>101.515</b>	<b>91.377</b>	<b>56.905</b>	<b>49.084</b>	<b>41.119</b>	<b>19.681</b>
<i>Capital (GST excl)</i>						
Emergency pressure – Health Capital Envelope	-	-	50.000	100.000	350.000	-
<b>Total capital funding requested</b>	<b>-</b>	<b>-</b>	<b>50.000</b>	<b>100.000</b>	<b>350.000</b>	<b>-</b>

### Emergency pressures and policy priorities

2. The Minister of Health's preferred Health budget package assumes available funding levels of up to \$806 million. This package seeks funding for:
  - Emergency pressures totalling \$578 million – Treasury supports emergency pressures of \$468 million to provide funding for price and volume pressures in DHBs (FFT and Demo) and to increase DHB deficit provisioning. The remaining submitted pressures do not meet the emergency pressure criteria;
  - All 100 day priorities per Cabinet agreement – Total of \$27 million for Voluntary Bonding Scheme, Plunketline and Herceptin;
  - All government Health manifesto commitments totalling \$181 million – Treasury supports funding \$126 million (including an FFT top-up to help manage industrial relations commitments). Many proposed initiatives can be deferred or scaled, some are underdeveloped and/or the costings have not been able to be thoroughly assessed by either the Ministry of Health or the Treasury. Some

initiatives are for items for which DHBs are already funded. For initiatives not deferred but needing further work, Ministers will need to decide whether they are held in a tagged central contingency pending final policy advice or are appropriated directly to Vote Health through the Budget (as has been the practice in the past);

- A capital allocation of \$500 million – this funding is being sought even though there is significant one-off funding within the operating package which could be used for this purpose. The Ministry of Health has since advised that only \$263 million capital pressures from this bid merit consideration in Budget 2009, and has also recommended that this be met from the one-off funding within the operating package. Treasury recommends capital funding of \$200 million from Health's operating package to reduce pressure on the central capital allowance, with no additional contribution required.
3. See Annex 1 for an outline of health sector emergency pressures and government priorities. Annex 2 provides an outline of health sector capital pressures.

### **Savings**

4. Treasury considers that the level of immediate savings found are modest given the size and recent growth of the Vote (see Annex 3 for an analysis of the Vote). However, we recommend you support these savings as a first step.
5. The modest level of savings is partially a result of the comparatively minimal incentives on Vote Health to find savings in Budget 2009. Unlike other Votes, Health was operating within the assumption that there would be a \$750 million Health allocation and that any savings found would be retained in the Vote (based on the December value for money letter to the Minister of Health). The Ministry of Health understood that this meant they only needed to find savings sufficient to balance the spending package. As the funding allocation was relatively generous, only modest savings were needed to achieve this. As it happens, only a small fraction of the savings is needed.
6. This is an example of how the perceived 'special arrangements' for Health isolate it from the rigour of analysis and disciplines being applied to other Votes and undermine incentives to drive for value-for-money within baselines. These arrangements will need to be reassessed by Ministers well before Budget 2010 if the necessary preparation for managing Vote Health to a much tighter fiscal constraint is to be achieved. The FFT and Demo adjusters also need review in this context: going forward, the sector needs to absorb more of its price and volume increases by becoming much more efficient.
7. Treasury's preferred Health package (see below) will assist Budget Ministers in bringing Budget 2009 within the goal of a \$1.45 billion Operating Allowance by reducing Health's net operating requirements by \$207 million per annum. Equally importantly, it will serve to improve the incentives on Health to find savings within baselines and to manage pressures by reprioritising low value expenditure and enhancing efficiency.

### **Health Budget package options**

8. Treasury has developed two health budget package options that illustrate the range of choices available to Ministers (summarised in the table below). There are many scaling, phasing and deferral options within the health package which allow Ministers to change its overall size. There is also scope for the Minister of Health to change the composition of initiatives within any of the packages outlined below to include or substitute some unfunded initiatives.

9. Given the uncertainty around the health pressures and what the final Government budget will look like, Treasury recommends provisional decisions are made on the health budget package now, and final decisions confirmed at the second Budget Ministers meeting on 27 March 2009. This will provide flexibility for Ministers to adjust the Health package (either up or down) according to available headroom or pressure on the Operating Allowance (OA).

*Option 1: Treasury's recommended package (\$622 million new health spending per annum)*

10. This package has been developed by applying the same scrutiny as Treasury has used for other areas of government spending. Only \$543 million is required from the Operating Allowance on top of savings and ACC PHAS revenue.
11. All key identified risks to the sector (in DHBs), the key government commitments and top government priorities are funded. This includes the top-up for DHBs to cover previous wage settlements. The remaining initiatives, many of which are underdeveloped or lower priority, can be deferred to future Budgets without service risks.
12. Some trade-offs are required in this package but Treasury considers them to be reasonable given the pressures being faced across the wider state sector. It is reasonable to expect the Minister of Health to defer some initiatives (phasing his priorities over the government's term) and to consider implementation within baselines where possible. DHBs are being fully compensated for price and volume pressures, which makes this package relatively generous. This option does not fund a risk reserve in the Vote and does not provide for FFT and Demo on Ministry-managed services except for the two pressures identified to date - in this environment, a large price and volume increase for all the Ministry's services seems unjustifiable.
13. This package could be adjusted to include one or more of the unfunded initiatives (such as an appropriately scaled initiative for training staff for new elective theatres) but this would have a direct and corresponding impact on the OA unless further savings are identified in time for Budget 2009.
14. This package brings Vote Health closer to the broader arrangements across other Votes, and sets Vote Health on a better path for managing the 3-5 year challenge of a considerably moderated growth path. Treasury considers there is considerable scope for further reprioritisation within the Ministry-managed contracted services, so any pressures that may arise during 2009/10 could be managed within a lower new health spending allocation. This would put similar pressure on the Ministry of Health to reprioritise and manage efficiently as applies to other departments.

*Option 2: Treasury's recommended \$750 million gross package*

15. This package meets the Government's stated objective to spend \$750 million on health this Budget. It will require a net \$694 million per annum contribution from the OA on top of savings and ACC PHAS revenue. This package funds *all* of the Minister of Health's initiatives (with some scaling and some alternate costings), apart from Additional Well-Child Checks (can be deferred), Boosting Hospice Care (DHBs already funded for this) and Mental Health increases (low value).
16. Treasury has seen no evidence that an additional \$93 million of pressures (emergency) needs to be funded within Ministry-managed services. We recommend that this funding be held back until the Ministry has supplied joint Ministers with an account of the pressures that need to be managed. If funding is made available now, Ministry and Treasury officials agree that there should be a report back in July about how this funding is applied across the Ministry-managed baseline.

*Summary of Treasury's Health Budget Package Options*

	<b>Option 1: Recommended package</b>	<b>Option 2: \$750 million new spending</b>
Total new spending	\$622m	\$750m
<b>Funding sources</b>		
OA	\$543m	\$694m
Savings	\$22m	\$22m
ACC PHAS	\$34m	\$34m
Savings from zero risk reserve	\$23m	-
<b>Emergency Pressures</b>		
Funded	Real emergency pressures: <ul style="list-style-type: none"> <li>• DHB FFT + demo</li> <li>• The only two identified pressures within MoH-managed baselines</li> <li>• DHB deficit support</li> </ul>	All Emergency pressures funded under Option 1, as well as <ul style="list-style-type: none"> <li>• Additional \$93 million for as yet unidentified pressures in Ministry-managed funds</li> <li>• A risk reserve</li> </ul>
Not funded	<ul style="list-style-type: none"> <li>• Risk reserves</li> <li>• \$93 million FFT and Demo for unidentified pressure in Ministry-managed funds</li> <li>• Mental Health</li> </ul>	<ul style="list-style-type: none"> <li>• Mental health</li> </ul>
<b>Priorities</b>		
Funded	All 100 day commitments. Seven policy priorities, including <ul style="list-style-type: none"> <li>• Medical and GP training</li> <li>• Increase to Pharmaceuticals budget</li> <li>• Devolution to primary care</li> <li>• Nursing in aged residential care</li> <li>• Respite care for older people</li> <li>• Longer post-natal stays</li> </ul>	All priorities funded under option 1, as well as: <ul style="list-style-type: none"> <li>• 800 staff for elective theatres</li> <li>• Optional GP/LMC visit for 'at risk' mothers</li> <li>• 2 small training initiatives</li> </ul>
Not funded	Six lower value priorities, many of which are not ready to implement, including <ul style="list-style-type: none"> <li>• 800 staff for elective theatres</li> <li>• Boost Hospice Care</li> <li>• Additional Well Child checks</li> <li>• GP/LMC optional visit per trimester for 'at risk' mothers</li> <li>• 2 small training initiatives</li> </ul>	<ul style="list-style-type: none"> <li>• Boost Hospice Care (DHBs are already funded for this)</li> <li>• Additional Well Child checks (funding not required until Budget 2010)</li> </ul>
One-off funding available	\$234m	\$230m
Capital	Fund all capital from spare one-off operating to a maximum of \$200m	Fund all capital from spare one-off operating to a maximum of \$230m

17. In both of Treasury's health package options, savings and ACC PHAS revenue are used to offset the costs of the health package. Treasury recommends you support this approach to reduce the net requirement from the OA and because the higher level of funding sought for Health (approximately \$806m per annum) *cannot be justified* in light of the priorities and pressures identified.
18. Under both options above, given DHBs are fully funded for price and volume pressures, DHB industrial relations will need careful management in order to avoid pay increases that other state sector employers can't afford to match.

### *Increase to the Health Capital Envelope*

19. The Budget capital increase in Health is treated as a roll-out of the Health Capital Envelope (HCE) in the outyear, rather than the funding of specific capital pressures. Outyear funding allows the approval of projects with long lead times without precommitting future Budgets.
20. The level of the roll-out should be based on what is considered a sustainable annual increase to the HCE envelope that will enable the funding of likely high priority proposals, but which will also maintain an appropriate level of constraint to ensure a focus on rigorous prioritisation and the approval of only high value capital projects. Annual increases should ideally be part of a relatively smooth funding trend, that is fiscally sustainable, to help manage sector expectations and enable trade-offs across allocation rounds.
21. Not all DHB submissions are high quality, high priority projects that need to be funded. \$106 million is currently available in the HCE across the forecast period. The Ministry of Health is recommending a further increase to the HCE of \$263 million. This figure is based on an assumption that nearly all projects likely to be sufficiently developed for approval in 2009 should be progressed.
22. Treasury considers a capital allocation of \$150 million to \$200 million is an appropriate roll-out of the HCE in Budget 2009. This level of funding:
  - allows the highest priorities to be approved in 2009 and prevents the build up of pressures for consideration in future years (\$150 million would likely be sufficient for this purpose);
  - will help drive better prioritisation and the business case analysis needed in a more constrained fiscal environment (Treasury considers the Ministry recommendation would not require significant trade-offs or scaling decisions);
  - is in line with previous HCE roll-outs (circa \$300m, \$140m, \$140m in last three years);
  - fits with a roll-out path of around \$150 million per annum over the next three Budgets that would likely meet high priority Auckland demographic pressure capacity proposals.
23. In light of the one-off funding available in the health package (see below), Treasury recommends an increase of \$200 million to the HCE in Budget 2009.

### *One-off funding*

24. All of the Health packages leave large amounts of one-off operating funding in the forecast period due to the rising profile of initiatives from 09/10 and available savings/underspends in 08/09. Adopting either of Treasury's packages will create approximately \$230 million of one-off funding over the forecast period given the 2008/09 savings and the rising profile of new initiatives. Treasury recommends transferring this operating funding to capital. The Ministry of Health supports this approach.
25. If all one-off funding is transferred to capital, Treasury recommends that any funding over \$200 million be used to offset Budget 2010 capital requirements. Ministers will also be able to use the one-off funds to increase DHB deficit provisioning should that prove warranted based on updated information from DHB District Annual Plans that will likely be available before the next Budget Ministers meeting.

## **Recommendations**

Treasury recommends that you:

- (i) **Support** the savings submitted for Vote Health. **Yes/No**
- (ii) **Agree** that Health's savings and ACC PHAS revenue offset the total costs of the Health package to reduce the overall impact on the Operating Allowance. **Agree/Disagree**

### *Health Budget Package Options*

- (iii) Either
- a. **Support** Option 1, Treasury's recommended package (\$622 million total new health spending); **Yes/No**
- Or
- b. **Support** Option 2, Treasury's \$750 million package (\$750 million total new health spending); **Yes/No**
- Or
- c. **Invite** the Minister of Health to prepare a package to be considered at the second Budget Ministers meeting of 27 March with total health spending of:
- |      |               |  |
|------|---------------|--|
| i.   | \$620 million |  |
| ii.  | \$700 million |  |
| iii. | \$750 million |  |
- Agree/Disagree**

- (iv) **Agree** that the Health budget package be finalised at the second Budget Ministers meeting of 27 March in light of the overall Budget package and fiscal strategy. **Agree/Disagree**

### *Underdeveloped initiatives*

- (v) Either
- a. **Agree** that underdeveloped initiatives that are not deferred to future Budgets be set aside in a tagged central contingency pending further policy development (standard arrangement). **Agree/Disagree**
- Or
- b. **Agree** that underdeveloped initiatives that are not deferred to future Budgets be appropriated and held as contingency items in Vote Health (previous practice for Health). **Agree/Disagree**

### *FFT and Demo for Ministry-managed funds*

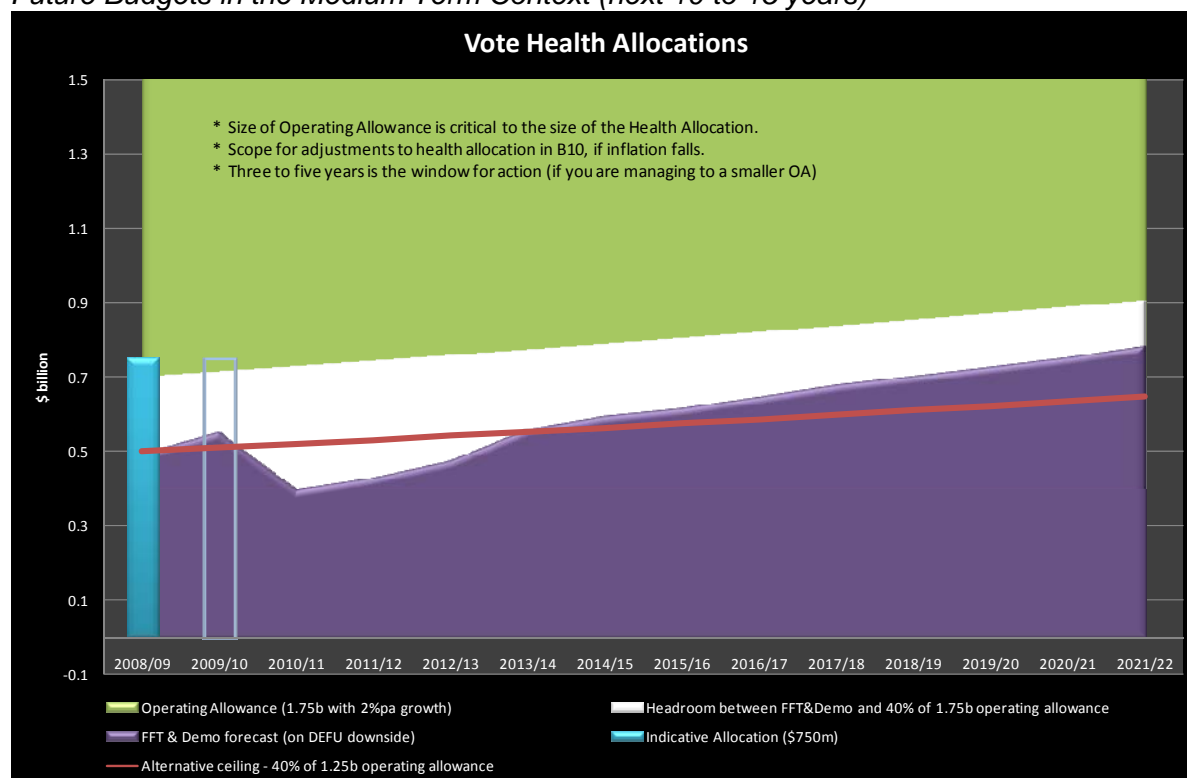
- (vi) **Direct** Ministry of Health officials to report back to Joint Ministers on proposed application of FFT and Demo across Ministry-managed NDE pressures for 2009/10 before any funding above the level specified in the minimum package (Option 1) is allocated. **Agree/Disagree**

### *Capital*

- (vii) **Agree** to a health capital allocation of \$200 million in Budget 2009. **Agree/Disagree**
- (viii) **Agree** that all one-off funding inside the forecast period be swapped to capital to fund Health sector capital requirements and that any funding over \$200 million offset Budget 2010 capital requirements. **Agree/Disagree**
26. **Note** that information on DHB deficits for 09/10 is still to be analysed and may require an increase to deficit support provisions which can be managed from the one-off funding in the package.

27. In Budget 2009, Ministers need to make decisions on:
  - a. Completing the Line-by-Line review and the key future value for money work in Health, including further work on future Health budget arrangements;
  - b. Whether to set an indicative allocation for Health in Budget 2010, and potentially, 2011; and
  - c. Further work on the future management of health capital spending.
28. Recent health expenditure growth rates have been significantly higher than what is likely to be affordable in future Budgets given current fiscal and economic conditions. Health has been taking a large and increasing share of the government's funding available for new spending, and current indicative allocation levels will crowd out government's other spending options and its ability to retire debt.
29. Setting a tighter Budget constraint in Budget 2009 will help to set Vote Health on a more sustainable path. However, in Treasury's view, significantly smaller allocations to Health from Budget 2010 are both feasible and necessary.
30. In the short-term, capital is probably the biggest pressure in Health. The key health sector operating pressure (the FFT and Demo price and volume adjuster for DHBs and Ministry-managed services) is forecast to fall to approximately \$400m in 2010/11 which should make a much lower allocation achievable more or less within current settings. However, on current forecasts, and depending on the size of the overall Operating Allowance, even the FFT and Demo adjuster will be difficult to afford within the next 3-5 years. (Based on the downside scenario for DEFU, FFT and Demo is forecast to grow to \$780 million by Budget 2021 but would outstrip an illustrative 40% of a \$1.25b OA by 2013.) This suggests an urgent need to reconsider the Budget approach for Vote Health and the role of the 'automatic' adjusters going forward.

### Future Budgets in the Medium Term Context (next 10 to 15 years)



31. Managing health within lower allocations will add incentives and pressure to get the most value out of existing resources (including in DHBs) even in the short term. This is the key challenge looking forward. It will require action on a number of fronts:
- a harder look for savings within existing Ministry-managed baselines (DEs and NDEs) from cutting lower value expenditure – essentially accelerating the work begun by the Ministry's Line by Line Review and the Ministerial Advisory Group to create headroom for Budget 2010 and beyond;
  - bringing Health more in line with the disciplines applied across other areas of state spending, and applying higher scrutiny on new health spending in terms of demonstrable costs and benefits;
  - smarter purchasing at all levels and getting in place stronger systems for prioritising health treatments, interventions and services based on cost-effectiveness to improve allocative efficiency and ongoing value for money; and
  - revisiting core policy, funding, and institutional settings to improve supply-side efficiency and demand management in the sector.
32. The Ministry of Health, and the Ministerial Advisory Group, have a number of work programmes or proposed work areas that will contribute to improving value for money and health sector performance. However, the work programme needs to be more targeted and more focussed on the fiscal reality. Greater specification, focus and phasing is required in terms of the priorities for further value-for-money work – and it needs to shift to a focus on efficiency in DHBs, including the scope for improving DHB efficiency to reduce future reliance on FFT and Demo funding over time.
33. This work needs to be driven by an overarching focus on what needs to be done now to reposition the sector within the 3-5 year window; that is, the key policy choices and changes that Ministers could make to core settings to lift productivity and deliver better health services within a significantly lower growth path beginning in Budget 2010. This work will need to include looking at resetting primary care funding arrangements and incentives, reassessing current IR arrangements and enforcing a strong line on remuneration changes, overhauling the ownership monitoring regime for DHBs, and revisiting institutional arrangements to increase efficiency over time. Initial decisions in these and other key areas will likely be needed by the end of this year to impact materially on the 3-5 outlook for health, as shifting sector performance will be challenging and will take time.

## **Recommendations**

Treasury recommends that you:

- (ix) **Direct** the Ministry of Health to provide a follow up report to the Line by Line Review for joint Ministers by April 2009 outlining the priorities for further value for money work, with a focus on DHBs, and key deliverables for the next 6 to 12 months; and
- (x) **Direct** the Ministry of Health to provide a report to joint Ministers by May 2009 on creating headroom for Budget 2010 (and potentially beyond) through savings from Ministry-managed baselines (including departmental expenditure); and
- (xi) **Direct** the Treasury and the Ministry of Health to report to joint Ministers by May 2009 on the sustainability and appropriateness of Health Budget arrangements, including the future role of 'automatic' adjusters, in light of the 3-5 year fiscal outlook and the need to reposition the sector; and
- (xii) **Direct** the Treasury and the Ministry of Health to report to joint Ministers by June 2009 on options to improve the ownership monitoring regime for DHBs.

## Indicative Allocations: Budgets 2010 and 2011

34. Current indicative allocations signal an increase to Vote Health of \$750 million in Budget 2010, but Treasury considers that a lower allocation will be both feasible and necessary. Indicative allocations are usually reviewed and set by Joint Ministers as part of Budget discussions. The intent of indicative allocations is to help manage expectations and to provide a planning horizon for the sector. In practice, planning seems to extend only as far as DHBs using signalled FFT and Demo for District Annual Planning rounds. To some extent, 'certainty' for the sector comes at the cost of some flexibility for the Crown, which may not be desirable, all things considered, in the current economic and fiscal environment.
35. Decisions to set indicative allocations need to be made in light of the fiscal environment and the size of the Operating Allowance as well as pressures the health sector is likely to face over the coming years. Savings and reprioritisation are also key considerations as there is considerable scope within Vote Health baselines to manage pressures.
36. The indicative allocation for Budget 2010 should not be set *at least* until decisions on the Fiscal Strategy are made (in April 2009).
37. Treasury recommends leaving the decision to later in the 2009 to allow greater flexibility for Ministers in light of the uncertainty around prevailing economic and fiscal conditions. This would enable Ministers to consider reprioritisation opportunities within the Vote and the work arising from the reports recommended above, as well as the Ministerial Group's reports. *This would mean that no indicative health spending allocation for Budget 2010 is set in Budget 2009.*
38. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].*
39. A conservative indicative allocation will help manage expectations. It could be raised if conditions allow at Budget time (this would also put the burden of proof on the Minister of Health to identify strong initiatives for a higher level of spending).
40. Whichever decision is made, any public comment on indicative Health allocations needs to be heavily conditioned on the current fiscal and economic uncertainty (i.e. it cannot be guaranteed) and the need to moderate health spending growth.

## **Recommendations**

Treasury recommends that you:

*Either (Treasury preference)*

(xiii) **Defer** setting an indicative allocation in Budget 2009 for Budget 2010 (and 2011) and consider the matter again in a bilateral strategy session in July.

**Agree/Disagree**

*Or*

(xiv) [information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].

Agree/Disagree

### Medium-term Capital Landscape

41. In recent years, Health Capital Envelope funding levels have not required tough prioritisation decisions. The 3-5 year outlook likely means tighter fiscal constraint. At the same time, a new phase of demographic pressure from the Auckland region will result in significant Crown investment being sought to build capacity.
42. This transition can be managed within feasible fiscal parameters by strengthening business case development and review, improving regional and national planning and prioritisation decisions across years and strengthening DHB asset management. Treasury recommends Ministers commission two pieces of work to help drive these changes.

#### *Action 1: Investigate a capital funding signal*

43. A longer-term capital funding signal would help to manage sector expectations and also better inform longer-term regional and national capital prioritisation and planning within feasible fiscal parameters. DHBs are currently preparing business cases on the basis of individual pressures and local affordability considerations with little reference to affordability, or relative priority, within the Health Capital Envelope.
44. Determining the level and form of a signal will need to take account of future Health allocation arrangements, the 3-5 year fiscal strategy, wider infrastructure and asset management planning and DHB asset management plans and arrangements.
45. Treasury, in consultation with the Ministry of Health, will prepare further options to be considered alongside wider fiscal and state wide asset management discussions.

#### *Action 2: Produce a top-down service-led capital prioritisation framework*

46. There is a need to improve the tools available to help make tough prioritisation calls and manage future pressures before they gain momentum. At the moment the process is primarily reactive to DHB submissions and there is no strong proactive national view about where and how scarce capital resources can best be deployed in the sector.
47. Treasury recommends Ministers direct officials to develop a top-down service-led capital prioritisation framework. Ideally this would be informed by work under way in the Ministry on future models of care and regional/national planning, and evidence-based policy judgements about appropriate services in different regions. A central view of appropriate regional service configuration, models of care and asset development will also help to prioritise amongst different types of pressure (e.g. how do we think about asset modernisation versus demographic pressures?).

### **Recommendations**

Treasury recommends that you:

- (xv) **Direct** Treasury, in consultation with the Ministry of Health, to report back to joint Ministers on current health capital arrangements including a longer term capital funding signal, by June 2009; and
- (xvi) **Direct** the Ministry of Health, in consultation with Treasury, to report back to joint Ministers by July 2009 on progress towards the development and implementation of a top-down capital prioritisation framework.

## Overview of Vote State Services

48. As part of the Minister of Finance's request to Vote Ministers to carry out a line-by-line review, submission of emergency pressures and policy priorities, the Minister for Vote State Services submitted the following:

	<i>\$million - increase/(decrease)</i>				
	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12</i>	<i>2012/13 &amp; Outyears</i>
<i>Operating (GST excl)</i>					
Savings	(0.140)	(1.906)	(0.036)	(0.036)	(0.036)
Emergency pressures	-	-	-	-	-
Policy priorities	-	-	-	-	-
<b>Total funding requested</b>	<b>(0.140)</b>	<b>(1.906)</b>	<b>(0.036)</b>	<b>(0.036)</b>	<b>(0.036)</b>
<i>Capital (GST excl)</i>					
Savings	-	(0.800)	-	-	-
Emergency pressures	-	-	-	-	-
Policy priorities	-	-	-	-	-
<b>Total funding requested</b>	<b>(0.000)</b>	<b>(0.800)</b>	<b>(0.000)</b>	<b>(0.000)</b>	<b>(0.000)</b>

49. Subsequent to the line-by-line submission, the Minister for State Services has identified a further saving in 2009/10 of \$1.000m (operating) and \$0.800m (capital) from the Authentication Program (e-govt Output Expense); this is included in the table above. Note that this funding is sourced from a number of Government agencies that contribute to the program, rather than direct from the SSC baseline. Treasury supports this additional saving.
50. Treasury's view on the savings submitted by the Vote is that this is a fair assessment of immediate operating savings available from Vote SSC, though further savings should be possible as a result of proposed downsizing of the entity, once implemented.
51. It should be noted that the majority of savings identified over the next two years are not available for reprioritisation as they were applied by SSC to the Government Shared Network (GSN) initiative, as agreed by Cabinet in February 2009.
52. In addition to the line-by-line review, SSC undertook a comprehensive review of their capital and operating expenditure in response to pressures from the operating losses associated with the GSN. SSC identified \$6.5m in 2008/09 (\$5m of which was a transfer from the Broadband Investment Fund), \$3.486m in 2009/10 and \$3.236 ongoing. The majority of this funding was applied to the GSN shortfall and exit costs over the next two years (as agreed by Cabinet (CBC Min (09) 2/6)).
53. The identified ongoing annual savings of \$3.236m represent around 5% of the Departmental appropriations of \$60m. It should be noted that with the 1 July 2009 transfer of the Government Technology Service (GTS) to the Department of Internal

Affairs (DIA), the SSC Departmental baseline will be in the range of \$30-40m per annum, and the savings therefore represent around 10% of the baseline for 2009/10.

54. These savings are, however, proposed to be largely retained by SSC to cover the transfer of overhead costs for GTS to DIA (\$2.4m p.a.), and for an anticipated rent review (\$0.8m p.a.). It could be argued that the Commission and or DIA should absorb all or some of these costs, though it is unclear what capacity will remain after the proposed restructure (discussed below). We recommend that this be considered as a source of further ongoing incremental savings.
55. The SSC has undertaken a review of functions, and proposes to reposition itself to “a smaller, more focussed Commission”. This proposal will provide ongoing savings of around \$2.5m p.a. and a proposed reduction of 20 to 30 FTE’s (from around 180 FTEs). The detail of the revised functions and organisational structure are due to be announced to staff for a consultation period during March 2009, and is confidential until announced.
56. In addition to this proposed reduction in FTEs, the transfer of GTS will move another 60 staff out of SSC. The medium term intention is for ‘Learning State’ (the State Sector Industry Training Organisation) to become a standalone entity, and this will further implement SSCs move to being a smaller more focused entity.
57. SSC was provided in February 2009 a capital injection (to a practical minimum level agreed with OAG), as it had depleted cash reserves by funding revenue shortfalls for the GSN. A return of any capital is impractical at this stage, but when the downsizing has occurred, a lower level of operating capital may be required. As noted above, the capital saving of \$0.800m in 2009/10 is from the Authentication Program, and is sourced from contributions from other Government agencies.
58. We believe that the following items could be discussed to identify further savings:
  1. Absorbing within baselines the anticipated \$0.800m p.a. increase in premises rental.
  2. Look to further reductions in baselines and working capital in subsequent years (such as in areas of overhead and corporate costs), as a result of a significantly reduced headcount.
  3. A reduction in anticipated salaries, bonuses and development costs for state sector CE’s. We note that a saving has been offered of the anticipated increases in the next two years, i.e. baselines are set to a nil increase.

## **Analysis of Vote**

59. Vote State Services baselines are shown in the graph below. The Vote has received increases in Departmental funding in the past 5 years partly as a result of an expansion in the range of functions undertaken by the Commission.
60. As noted above, the Commission proposes to reverse this trend and focus on core SSC activities, with other functions being downsized or transferred. The Departmental baseline is expected therefore to reduce over the forecast period to approximately \$30-40m per annum (close to 2004 /05 level). However, not all of this reduction is a fiscal saving to the Crown due to transfer of functions and corresponding baselines to other agencies.
61. The Non-Departmental increases reflect the increases in state sector CE remuneration and SSRSS / Kiwisaver contributions administered by SSC.



## **Recommendations**

Treasury recommends that you:

- (xvii) **Support** the savings submitted for Vote State Services, plus the subsequently identified saving from the Authentication Programme of \$1.000m (operating) and \$0.800 (capital) in 2009/10.

***Agree/Disagree***

- (xviii) **Discuss** with the Minister of State Services further savings in the areas outlined above:

- a. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*
- b. Look to further reductions in baselines and working capital in subsequent years (such as in areas of overhead and corporate costs), as a result of a significantly reduced headcount.
- c. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].* We note that a saving has been offered of the anticipated increases in the next two years, i.e. baselines are set to a nil increase.

***Agree/Disagree***

### **Emergency Pressure**

62. The Minister has not submitted an emergency pressure bid, but we note that Cabinet agreed in February 2009 (CBC Min (09) 2/6) to additional operating and capital for the exit of the GSN, much of which could be considered an emergency pressure bid.

### **Value for Money/Strategic Direction**

63. The next step in Value for Money for Vote State Services is to consider the respective role of the Central Agencies, and ensure that there are no areas of overlap or economies of scale in aggregation. With the increase in monitoring of capital projects by Treasury, and procurement work being undertaken by MED, there may be an opportunity to reduce further the roles undertaken by SSC, such as the oversight of ICT.
64. The main issues that will affect Vote State Services in Budgets 2010/11 and 2011/12 are the impact on the cost structure of SSC as it becomes a smaller and more focused entity. It could be expected that over time the overhead and corporate costs will reduce incrementally as scale allows.

## Annex 1 – Health Budget Package Initiatives

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### **Initiatives supported by Treasury**

#### Emergency Pressures

*FFT and demographics for DHBs (\$440 million per annum)*

This funding is critical to allow the sector to manage price and demand pressure to maintain service coverage levels. Treasury supports the allocation of the funding to DHBs.

*DHB deficit support (\$53.332 million in 09/10, \$8.332 million per annum ongoing from 12/13)*

This funding is to increase the DHB deficit reserve held within Vote Health in line with forecast deficit levels in 2009/10 and outyears. Treasury supports this initiative as a prudent reserve. The level of deficit funding could be adjusted further after District Annual Plans have been received and assessed.

#### 100-days commitments

Funding for the Voluntary Bonding Scheme, fully funding Plunketline, and the pharmaceutical costs of 12-months Herceptin was agreed by Cabinet earlier in the year. Treasury supports this funding in line with Cabinet decisions.

#### Government Priorities

*Supplementary funding (\$93.310 million per annum)*

This bid comprises a price catch-up for DHBs (effectively making FFT 4% to cover ongoing costs of recent IR settlements) on the understanding that DHB deficits will not deteriorate and DHBs will deliver on five specific government priorities (longer postnatal stays, quality of nursing in residential care, boosting funding for subsidised medicines, devolving some services to primary care, and respite care for older people). As a funding signal has already been given to DHBs, Treasury supports this bid. We recommend Ministers direct a report back to Cabinet on implementation of the specific components of this bid and the financial stability of the sector.

*60 Medical student places (\$1.125 in 09/10 rising to \$28.104 million in 23/24)*

This initiative increases medical student training places by 60, and is the first tranche of the Government's signalled increase of 200 medical training places. Treasury supports this initiative as a way of addressing workforce capability needs in the health sector. Any future proposals to increase medical student places should be considered alongside other means of improving workforce capability to meet demand (such as improving doctor retention rates and making smarter use of the existing mix of workforce).

*GP training (\$2.5 million in 2009/10 then \$5 million per annum)*

This initiative increases the number of GP postgraduate training places funded from 104 to 154 starting from the 2010 academic year. The college has advised that there is sufficient demand that the places will be filled from the first year. Treasury supports this initiative.

### **Initiatives Treasury recommends be scaled**

#### Emergency Pressure

*FFT and demographics for Ministry-managed contracts (\$113 million per annum)*

Treasury and the Ministry of Health agree that the management and monitoring of Ministry managed NDEs needs significant improvement. Only two pressures (Maternity volumes and IDCC&R capacity, approximately \$20 million) have been identified by the Ministry against this funding, the remaining \$93 million is for as yet unidentified price and volume pressure. Treasury recommends that only the two identified areas of pressure are funded. Any further pressure within Ministry-managed NDEs could be managed through reprioritisation.

If Ministers wish to fund the full \$113 million, Treasury recommends Ministers direct Ministry of Health officials to report back to Joint Ministers on proposed application of FFT and Demo across Ministry NDEs before any funding given above the minimum package is allocated.

## **Initiatives not supported by Treasury**

### Emergency Pressures

#### *Risk reserves (\$30 million per annum)*

Vote Health has historically held funding in baselines to manage risks that arise during the year (in addition to the DHB deficit support reserve). The Ministry of Health's current risk register mostly contains items that do not appear to be non-deferrable risks, but pressures that should be managed through FFT and demographic funding or new initiatives that should be considered as part of a future Budget. Treasury recommends no risk reserves be set aside in Budget 2009 and that risks be managed from baselines in the first instance.

#### *Mental health Blueprint (\$10 million per annum)*

This initiative has been substantially scaled from previous years' bids, to fund only specific prioritised services (eating disorders, youth services). Not funding at this time may carry some service risk to Bay of Plenty DHB and may also be inconsistent with earlier Cabinet decisions regarding provision of ring-fenced mental health funding to fill service gaps ('Blueprint' funding). However, Treasury recommends you do not support this initiative as these services should be funded by DHBs from within their population funding (FFT and demographics), and that Ministers make it a priority to review Blueprint funding.

### Government Priorities

#### *Train 800 additional staff for electives (\$10 million in 09/10, \$20 million per annum ongoing)*

There are choices around the level and timing of funding this initiative. The initiative has not been fully developed and it is unclear what all the funding will be used for. Major service planning that considers both capital and operating impacts is needed before implementation can begin. Treasury recommends not supporting this bid in Budget 2009.

If Ministers wish to fund this bid, Treasury recommends funding it at the Ministry of Health's initial alternative costings of \$3.4 million in 2008/09 rising to \$12.3 million in 2012/13 and outyears, and that the funding is indicatively allocated pending further policy and planning work.

#### *Additional Well Child visits (\$15.36 million per annum from 10/11)*

There is insufficient evidence that all mothers will benefit from the three additional visits, meaning there is scope to scale this initiative based on targeting to identified risk. Funding for this initiative is only sought from 2010/11 so there would be no impact from deferring it to Budget 2010.

If Ministers wish to fund this bid, Treasury recommends this initiative be targeted to at risk mothers only with a cost of \$13 million per annum.

#### *Boost Hospices (\$15 million per annum)*

This is in effect a price increase for hospices on top of what they are already funded by DHBs. FFT and demographics is provided to DHBs to manage cost pressures as they arise in the services they fund, including hospices. Treasury does not support this bid as it should be funded from baselines.

If Ministers wish to fund this bid, Treasury recommends funding at no more than a scaled cost of \$12.4 million which would match the costings provided by Hospices New Zealand.

#### *Other initiatives*

Indicative allocation of funding is sought for initiatives to encourage training in rural areas (\$1 million ongoing) and to provide an optional GP/LMC visit per trimester for 'at risk' pregnant women (\$2.8 million ongoing). These initiatives are not fully developed so Treasury recommends the funding decision be deferred until Budget 2010.

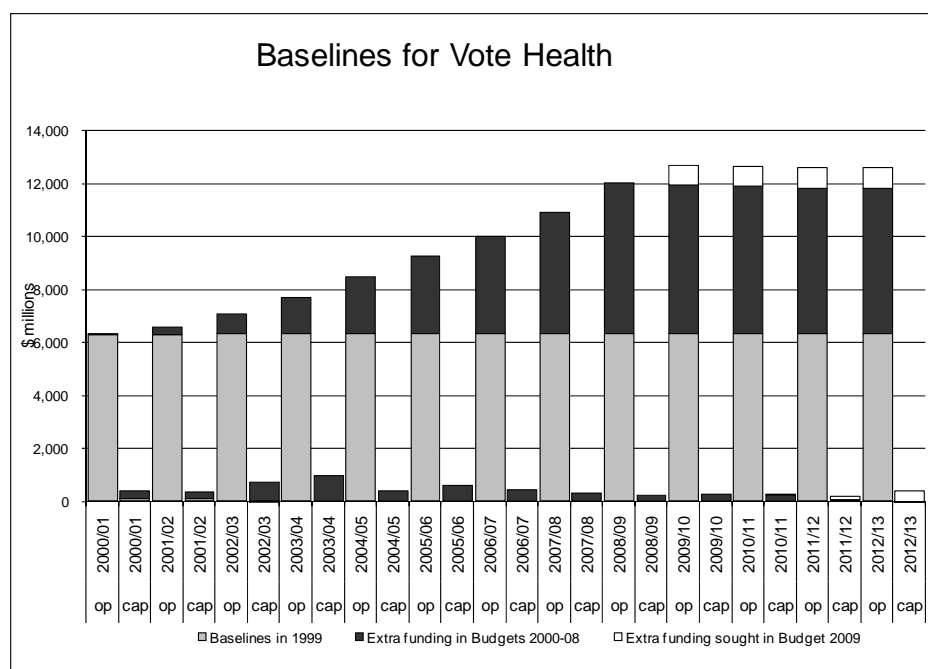
A further initiative to subsidise GPs who wish to take refresher obstetrics training is very small (\$300,000 per annum) and funding should be sourced from within baselines.

*Annex 2: [information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].*



## Annex 3 – Analysis of the Vote

Total Vote Health baselines are shown in the graph below<sup>1</sup>. Health expenditure has nearly doubled since 2000/01. Forecast Funding Track and Demographics (FFT and Demo) made up approximately 44% of this increase (approximately \$2.5 billion) which has enabled the sector to manage price and volume pressures and maintain service coverage. The remaining 66% of the growth over this period has expanded the role of the public health sector and addressed pressures or priorities in specific policy areas such as primary health, health of older people, and elective surgery volumes.



<sup>1</sup> This data is drawn from the Supplementary exercises from 2000/02-2007/08 and then uses OBU baselines for 2008/09 onwards.