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Date: 18 September 2009

BM-2-1-2010

To: Bryan Dunne, Office of Minister of Finance

AIDE MEMOIRE: BUDGET 2010 STRATEGY: SETTING A HEALTH ALLOCATION

On Tuesday 8 September the Minister of Finance met Treasury officials to discuss budget management options for Vote: Health for next year. He indicated he wanted to confirm an overall figure for new health spending in Budget 2010 soon with the Minister of Health.

We take this to mean that he wants a firm agreement with the Minister of Health well in advance of allocations being discussed by Cabinet on 19 October.

This note seeks your views on how the Minister may wish to proceed. It identifies some key points to consider in setting an indicative Health allocation, and offers a list of key points that Ministers should agree to minimise any potential for uncertainty and confusion about what the agreed allocation is to cover and the process for making budget decisions.

We haven't yet discussed this note with the Ministry of Health. After getting your feedback we intent to share a revised draft with them to ensure any key issues of concern are covered off.

Deal with large votes together or case by case?

Does the Minister also wish to settle the indicative allocations for Education and Justice at the at the same time and in the same way as for Health, or will he tackle them each separately?

Meetings or correspondence?

We understand the Minister of Finance plans to meet with the Minister of Health to discuss the health budget allocation. If so, we propose that he use the following sheet of key points to support the discussion, minimise the risk of misunderstandings, and record decisions taken.

- The attached sheet proposes an indicative health allocation of \$300 million, and gives a short explanation for settling at this figure at this stage. *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions].*

If a meeting is not required at this stage, the Minister of Finance may wish to simply notify vote Ministers of their indicative allocations. If this is the case, we will work with the Fiscal Management team and other vote teams to draft letters for him to send next week.

[deleted – confidentiality of advice]

If the Minister wishes to set a number for Health early, it will be important to be clear what savings options are to be retained within the Vote as baseline realignment, and which savings may need to be returned to the centre to *[deleted – confidentiality of advice]*.

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

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Establishing an Indicative Health Allocation for Budget 2010

Context

1. The 2010 Budget process and timelines were discussed by ECC on 16 September and confirmed by Cabinet on 21 September [ECC Min (09)16/3 refers].
2. The overall new spending allocation for Budget 2010 is still to be determined. It will be less than the \$1.1 billion operating allowance signalled in the 2009 Budget as this also needs to cover between-budget spending that exceeds the 2009 contingencies, and other risks and commitments.
3. *[deleted – confidentiality of advice]*
.These may require lower net growth in operating expenditure in 2010, with a reduced new spending allocation and/or savings from votes to be returned to the centre.
4. This means a firm number for Health cannot be “locked down” at this stage, but an indicative allocation or range can be set to frame agencies’ budget planning work.
5. Agreements can also be made now on Budget decision-making processes and on what “counts” against the Health allocation.
6. The sooner the size of the Health allocation can be signalled and the decision processes mapped out, the more chance Health have of successfully managing to this constraint. Late changes will compromise the ability to manage.

Timeframes

ECC Min(09)16/3

- Late September: Minister of Finance discusses and/or confirms with large votes’ Ministers their likely indicative Budget 2010 operating allocations;
- 12 October: Ministers discuss policy and budget priorities at Premier House
- 19 October: Cabinet will discuss indicative allocations;
- 16 November: Ministers to advise the Minister of Finance if they can’t manage their priorities and pressures within their indicative net allocations;
- 14 December: Cabinet decides final operating allocations;
- 8 March: Ministers report to Minister of Finance how they intend to allocate their baselines and net allocations to achieve gov’t priorities.

Indicative Operating Allocation Proposed for Vote: Health for Budget 2010

\$300 million annual net operating impact

Rationale

7. The Ministers of Finance and Health have received initial advice on 2010 budget scenarios with an increase in health operating expenditure in the range of \$200m-\$400m per year;
8. The Treasury’s draft “allocation shares” exercise indicates that if new funding were allocated to votes in 2010 according to their current share of crown-funded expense appropriations, the Health allocation would be in the range of \$200m-\$250m. Given the government’s priorities in health, the scale of previous increases to which the sector has become accustomed, and the challenge in managing back costs and pressures in the sector, a health allocation that low may not be sustainable without policy decisions to scale back service levels and/or transfer costs from the government to individuals.
9. A \$300 million Health allocation is a challenging but realistic and achievable figure for net health expenditure growth, given the government’s overall fiscal constraints for Budget

2010, the cost and volume pressures in the health sector, and the scope for DHBs to deliver real efficiencies or savings without driving up DHB deficits beyond current forecasts.

10. Given the ongoing work on *[deleted – confidentiality of advice]*, tax strategy, forecast updates and the Premier House meeting etc, any number set now may need to be revised later as event unfold.

Scope: The budget allocation is an “all-inclusive” net operating figure

11. The Health allocation should be seen as an “all-inclusive” net figure – or as close to this as possible with exceptions explicitly agreed in advance.
12. The basic rule is: all changes to operating costs in Vote: Health are to be managed within the agreed net allocation, unless joint Ministers explicitly agree that certain costs (savings) will be funded by (returned to) the centre. Vote Ministers and their Chief Executives are responsible for prioritising within existing baselines plus their share of the operating allowance to deliver policy priorities and meet cost pressures.
13. The health allocation encompasses all tagged contingencies for between-budget initiatives, all cost pressures, risk reserves, and operational flow-ons from capital expenditure;

<p>14. At present, all funds from reprioritisation within Vote Health are intended to be retained in the vote to help fund cost pressures and policy priorities. <i>[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].</i></p>

Time Profile: No Bow-Waves

15. Beyond the 4-year forecast period, the allocation figure is the upper limit on net baseline increases for each year.
16. Within the forecast period, the allocation is the maximum for average annual net increases in operating baselines.

Underspends

17. Consistent with the Minister of Finance’s 10 August letter, 2008/09 underspends are available as a tagged contingency to manage identified pressures in 2009/10 once other reprioritisation options (including risk reserves) are exhausted. The contingency will expire on 10 February 2010.
18. Future treatment of underspends in Vote: Health will be aligned with that for other votes – this is currently being reviewed as part of overall budget management rules for 2010.
19. Any uncommitted funds in the Health contingency established for 2009/10 from 2008/09 underspends will not be added to the 2010 Health operating allocation. This contingency is to manage 2009/10 pressures and any balance unallocated at February 2010 will be returned to the centre.

Decisions on composition of the 2010 Health package

20. Containing DHB deficits within forecast is essential to ensure that actual expenditure growth is managed within the agreed budget allocation. This will require: a sufficient share of new funding to be allocated to DHB FFT/Demo increases; a mix of pressure and flexibility for DHBs to deliver efficiency gains and manage costs within these budget constraints; and firm wage restraint.
21. DHB FFT/Demo, with achievable “efficiency adjusters”, will be the first priority and may consume the full 2010 health allocation, requiring reprioritisation within baselines to fund all other pressures and new initiatives.
22. The Minister of Health is to submit a proposed package (including allocation of new funding and baseline reprioritisation) for consideration by the Minister of Finance by 8 March 2010.

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23. Budget Ministers will need to assess the balance of funding within the Health allocation, including balance of funding for new initiatives and DHB FFT/Demo, and whether efficiency and deficit assumptions for DHBs are sustainable.
24. Budget Ministers may also agree changes at the margin to the value of the Health allocation, comparing the trade-offs required to manage within the indicative Health allocation to those faced by other votes and considering the overall balance of Budget 2010 proposals in light of the Government's priorities.

Capital

25. The process for allocating capital funding in Budget 2010 is yet to be decided.
26. The objective is to establish a more strategic and coordinated approach to capital expenditure, balance sheet management and infrastructure planning across government. The Health National Asset Management Plan, the National Infrastructure Plan and the cross-government Capital Asset Management process will serve as tools to inform capital prioritisation across all votes.
27. 2009/10 operating under-spends will not be retained within votes to fund capital expenditure in Budget 2010. They will be returned to the centre and Budget Ministers will determine any reallocation.