

Budget Report: Budget Ministers 24 February: Advice on Capital Bids

Date:	22 February 2010	Report No:	BR2010/12
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Agree initial recommendations on capital bids at Fiscal Issues on 24 February.	Wednesday 24 February, 12 noon
Prime Minister (Hon John Key)	Note the contents of this report.	None.
Associate Minister of Finance (Hon Simon Power)	Agree initial recommendations on capital bids at Fiscal Issues on 24 February.	Wednesday 24 February, 12 noon
Associate Minister of Finance (Hon Steven Joyce)	Agree initial recommendations on capital bids at Fiscal Issues on 24 February.	Wednesday 24 February, 12 noon

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[withheld – privacy]	Analyst, Fiscal Management	[withheld – privacy]	[withheld – privacy]	✓
Richard Downing	Acting Manager, Fiscal Management	[withheld – privacy]	[withheld – privacy]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: Yes.

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The capital allowance remaining to spend is [deleted – confidentiality of advice]. Treasury's initial assessment of the capital bids received supports \$1.001 billion although with some further options to scale and decline individual bids.

Treasury's initial assessment does not include a capital contingency or funding for KiwiRail's national network bid. Together, these two pressures could add [deleted – confidentiality of advice].

Treasury's assessment also excludes the net savings of the student support package proposed by Minister Joyce. *[Information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*. The costings of this package are still to be finalised and will depend on policy decisions regarding tertiary education settings.

Budget Ministers (excluding the Prime Minister) are meeting on Wednesday 24 February to discuss capital bids and Treasury's initial assessment. This report proposes that Budget Ministers:

- consider the use of student support savings to offset the costs of the capital package and/or to lower the gross cost;
- make decisions on a number of capital bids at this time; and
- subject to detail in Baseline Alignment Proposals, agree to hold bilaterals for Justice and Education.

Bilaterals can be scheduled after Budget Ministers have met on 16 March in order to pick up any further issues. All decisions should be resolved by the final Budget Ministers meeting on 31 March, in time for the Budget Cabinet paper on 19 April.

Finally, this report also includes discussion on capital and broader budget issues in Vote Health, seeking to address risks to the Budget in this Vote.

Recommended Action

We recommend that at Fiscal Issues on 24 February you:

- a **note** the capital allowance remaining to spend is [deleted – confidentiality of advice];
- b **note** initial Treasury assessments total \$1.001 billion, excluding student support savings and with no provision for a between Budget capital contingency or KiwiRail capital funding;
- c **note** net student support savings of [deleted – confidentiality of advice] will allow you to:
 - i decrease the net cost of the capital allowance; or
 - ii fund a higher gross cost without exceeding the allowance;

- d **agree** in principle to support a small number of capital initiatives at this point (page 10), subject to finalisation of a capital package in March;

Agree/disagree.

- e **agree** to invite Vote Ministers to fund a small number of capital initiatives from baselines (page 11);

Agree/disagree.

- f **note** Treasury will prioritise remaining projects (excluding those in Justice, Education and Health below) so that Budget Ministers can “draw a line” in March when they finalise the capital package (page 12).

Justice (page 13)

- g **agree** to meet with Justice sector Ministers to consider tradeoffs between new initiatives proposed and baseline activity in the sector *subject to consideration of the Justice sector Baseline Alignment Proposals*;

Agree/disagree.

Education (page 14)

- h **agree** to meet with the Minister of Education to set a global capital constraint for Education and discuss how to manage medium term pressures;

Agree/disagree.

Health (page 15 – 18 and Annex A)

- i *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions];*

- j **agree** to confirm with the Minister of Health as soon as possible that the amounts agreed to date are the final and binding budget constraint for new Health operating funding in Budget 2010;

Agree/disagree.

- k **agree** to request that the Health Baseline Alignment Proposal include a thorough analysis of Industrial Relations and DHB deficit risks in the sector and how these are to be managed within a balanced Health package;

Agree/disagree.

- I **agree** to inform the Minister of Health that any new capital pressures in Budget 2010 should be managed within the funding already available, and that this may include operating to capital transfers from the Health allocation and 2008/09 underspends if headroom is available in a balanced Health Baseline Alignment package that manages all 2010/11 operating risks;

Agree/disagree.

Richard Downing
Acting Manager
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Budget Report: Budget Ministers 24 February: Advice on Capital Bids

Purpose of Report

1. To set out pressures on the Budget 2010 capital allowance and consider initial recommendations on capital bids.

Capital Allowance remaining to spend

2. The remaining capital allowance for Budget 2010 [deleted – confidentiality of advice]. Because a number of bids are associated with offsetting revenue or savings, the capital allowance is effectively increased to [deleted – confidentiality of advice]. In addition, \$52 million operating in outyears is available for the flow-on costs of the capital allowance. This is set out in the table below:

Table 1. Movements in the Capital allowance

	Capital					Total	Operating	
	2009/10	2010/11	2011/12	2012/13	2013/14		2013/14	Total
Budget 2010 Allowance - Opening Balance	20	630	450	350	0	1450	50	200
Already Spent								
Auckland Electrification (CAB Min (09) 41/11)	-3	-34	-57	-189	-217	-500	0	0
Budget 2009 Contingency overspend	-35.5	-10	0	0	0	-45.5	0	0
Budget 2010 Allowance (less precommitments)	-18.5	586	393	161	-217	904.5	50	200
Offsets to particular initiatives								
							0	0
Housing Innovation Fund	0	8	0	0	0	8	0	12
Housing Memorandum Accounts	1.716	4.225	0	0	0	5.941	0	0
New Fines and Civil Enforcement Measures	0	2.664	0.571	0	0	3.235	1.74	5.937
							0	0
Budget 2010 Allowance to spend							51.74	217.937

[sections in the above table deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

- NB. The Housing Memorandum Accounts and New Fines and Civil Enforcement Measures offsets are only realised if the initiative is funded. The other three offsets ([deleted – confidentiality of advice], HIF, [deleted – commercial]) are directly related to their initiatives but could be realised without funding the initiative.
3. One option to marginally increase this allowance is the capital identified on the MSD balance sheet. At present Treasury is aware of up to \$30 million that could be returned, but we understand that MSD are considering this as part of their Baseline Alignment Proposal (BAP). We recommend a decision is made as part of consideration of the BAP.
 4. [information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

Pressures on the Capital Allowance

5. Vote Ministers are seeking \$1.889 billion capital in Budget 2010. This excludes [deleted – confidentiality of advice] for the KiwiRail business case to invest in the national network, and excludes a *saving* of [deleted – confidentiality of advice] from the flow-on capital costs of student support changes (student support changes are considered separately below).
6. Treasury's initial assessment of capital bids totals \$1.001 billion. Treasury's assessment includes zero new capital for Health (excepting the return of underspends which is the major factor in the overspend of the capital allowance) and zero funding for KiwiRail (indicative capital amounts required in Budget 2010 will not be known until mid-March) or for a Budget 2010 capital contingency.
7. A capital contingency of around \$100 million is standard practice, although a contingency of around \$50 million would be feasible. The KiwiRail business case indicates around [deleted – confidentiality of advice].
8. Treasury's assessment divides the capital bids into:
 - a. [Green] Projects that Budget Ministers could support now (although we would not recommend confirming this to Vote Ministers until a final package is assembled);
 - b. [Amber] Projects that either:
 - i. Are a major sector (Justice, Education and Health) where decisions should wait until trade-offs are revealed in Baseline Alignment Proposals and a subsequent bilateral is likely to be required; or
 - ii. Treasury proposes to more rigorously prioritise – so that Budget Ministers can 'draw a line' depending on how much funding is available after bilaterals.
 - c. [Red] Projects that we recommend Budget Ministers decline and inform Vote Ministers that the project requires baseline funding to proceed (so that this reprioritisation can be factored into BAPs if necessary).
9. Discussion of each of these categories is set out below on pages 10 – 18 of this report.

Fig. 1. Vote Minister submissions and Treasury assessment (by category)

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

10. The operating funding available for capital bids is less pressured. Treasury's assessment totals \$53 million in outyears (against \$52 million available) and there is no need for a between Budget contingency to be set aside from this funding. The Treasury Assessment excludes net operating savings from the student support package (savings of [deleted – confidentiality of advice] in outyears).

Treatment of Student Support Savings

11. The table and graph above *exclude* the net flow-on capital savings from proposed student support changes. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
12. The capital savings result from a reduction in forecast student loan borrowings as a result of proposed policy changes. The costings are still being finalised, and will always have a degree of uncertainty given that it requires making assumptions about student behaviour. The capital initiatives are to fund the loan costs of additional student places (demand flowing from the recession) and relaxing fee regulation, although the extra places may not be required as the student support package will free up funded places. The student support package will be considered in a separate Cabinet paper and the remaining initiatives will be considered through the BAP.

13. Excluding the net student support savings, Treasury's initial recommendations cost virtually the same amount as the remaining capital allowance. This presents two broad options:
- a. to use the student support savings to offset higher spending while still staying within a *net* \$1.45 billion capital allowance (Figure 2 below); or
 - b. to use the student support savings to reduce the net cost of the capital allowance, while staying within a *gross* \$1.45 billion capital allowance (Figure 3 below).

Figure 2. Lower net cost

Figure 3. Higher gross spend

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

14. Any intermediate point between these two options is also possible, and alternately there are also options to agree a higher or lower cost of initiatives regardless of the treatment of student support savings.

Weathertight Homes

15. Ministers are currently considering options on a weathertight homes package. One option being considered would lower the capital allowance over the next four years to around [deleted – negotiate without prejudice] per Budget. An indicative reduction is shown below:

Figure 4. Re-phasing of capital allowance

[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]

16. If this re-phasing is agreed, it would be desirable to demonstrate in Budget 2010 that the Government is able to manage capital pressures for less than \$1.45 billion (and ideally at whatever level Budgets 11 to 14 are set). Student support savings are an option to achieve such a lower *net* level of new capital spending.

1) Approve Now (green bids)

17. We recommend you agree to support [deleted – confidentiality of advice] of projects at this time (primarily [deleted – confidentiality of advice]; Broadband; and Asian Development Bank). A number of these projects are offset by related revenue (indicated in the table below).
18. We recommend you do **not** inform affected Vote Ministers at this time, to preserve flexibility as the overall capital package is finalised.

Table 2. Bids to (indicatively) approve now

ID	Vote	Title	Department		Treasury		Comment
			Capex	Opex	Capex	Opex	
5885	Finance	Asian Development Bank General Capital Increase	71	0	71	0	Support
5871	Housing	Capital Injections to fund Building Practitioner memorandum account deficits.	2.441	0	2.441	0	Support (does not count)
5872	Housing	Capital Injections to fund Electrical Worker memorandum account deficits.	3.5	0	3.5	0	Support (does not count)
5909	Communications	Crown Fibre Holdings Co-investment Fund	200	0	200	0	Support
[deleted – confidentiality of advice]							
5873	Housing	Housing Innovation Fund supporting the growth of the community housing sector	8	13.1	8	12	Support (does not count)
5927	Local Government	Local Government Borrowing Vehicle: Crown capital contribution	5	-0.875	5	-0.875	Support (contingency)
[deleted – confidentiality of advice]							
[deleted – confidentiality of advice]							
5938	Corrections	Wiri Prison Programme Management and Integration Activities	0	24	0	24	Support

2) Decline Now (red bids)

19. We recommend Budget Ministers request Vote Ministers fund the following bids within their own or related baselines:
- Disrupting “P” supply. A large number of agencies are likely to benefit from this initiative (Customs, Police, Health, Conservation, Immigration, and Security Intelligence Service). Accordingly we recommend the Minister of Customs develops a proposal with funding from relevant baselines.
 - [deleted – confidentiality of advice]
 - Future Focus. This is part of the Future Focus package to be considered at SOC on Wednesday 24 February.
20. [deleted – confidentiality of advice]
21. The Health capital bid is effectively in this category but is discussed separately on pages 15 – 17.

Table 3. Bids to decline now (and inform relevant Vote Ministers)

ID	Vote	Title	Department		Treasury		Comment
			Capex	Opex	Capex	Opex	
5870	Customs	Disrupting 'P' supply and dismantling criminal networks	5.9	7.155	0	0	Support (in baselines)

[deleted – confidentiality of advice]

5939	Social Development	Future Focus \$500 loans for DPB sole parents to study at levels 4 or above.	2.061	0.838	0	0	Do not support
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3) Treasury to prioritise (amber bids outside Justice, Education and Health)

22. We propose doing more work on the following proposals and business cases to ensure consistent treatment across different areas of Government. This will allow Ministers to “draw a line” through this list depending on the amount of funding remaining after bilaterals and consideration of the size of the between Budget contingency.

Table 4. Bids for Treasury to prioritise

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ID	Vote	Title	Department		Treasury		Comment
			Capex	Opex	Capex	Opex	
5824	Customs	Joint Border Management System - Stage 2 (Customs)	69.232	24.749	69.232	24.749	Support
5916	Agriculture and Forestry	Joint Border Management System - Stage 2 (Biosecurity)	6.668	0	6.668	0	Support Tranche 1 Funding for JBMS
5921	Biosecurity	Joint Border Management System - Stage 2 (Ag&Forstry)	0	15.93	0	15.93	Support

[deleted – confidentiality of advice]

5919	National Archives	Government Digital Archive	3.488	6.24	3.488	6.24	Support
5915	National Library	Government Digital Archive	2.88	0	2.88	0	Support

[deleted – confidentiality of advice]

[deleted – confidentiality of advice]

[deleted – confidentiality of advice]

5923	Transport	NZRC Loans – rollover of existing loan	170	0	0	0	Support
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4) Justice

23. The capital submission from the Justice sector states that “No funding priorities across the justice sector have yet been identified by officials, presented to Justice Sector Ministers or agreed [and] . . . decisions on the priorities for the sector will need to be made on the basis of the Baseline Alignment Proposals”.
24. As such, the capital submission at this stage outlines costs that may be incurred for certain capital proposals but does not speak to funding options.
25. We therefore recommend that decisions on the Ministry of Justice’s Performance Improvement Actions, Whare Oranga Ake and expansion at Mt Eden Prison be deferred until the Baseline Alignment Proposal for the Justice sector and the Baseline Alignment Proposals for the individual votes in the Justice sector are received. At this stage we expect that a Ministerial meeting may be required to confront the tradeoffs between new initiatives proposed and baseline activity in the sector.
26. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Table 5. Bids to discuss at proposed Justice bilateral

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ID	Vote	Title	Department		Treasury		Comment
			Capex	Opex	Capex	Opex	
5891	Corrections	Audio Visual Links (AVL) in Courts and Corrections Facilities: Phase 1	1.08	1.128	0	0	Support (in baselines)
5863	Justice	Audio Visual Links (AVL) in Courts and Corrections Facilities: Phase 1	2.442	3.218	0	0	Support (in baselines)

5936	Corrections	Mt Eden Prison Phase 2 (Stage 2)	0	45.3	0	45.3	Support
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[sections in the above table deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

5) Education

27. The Minister of Education has requested [deleted – confidentiality of advice] in new capital funding, comprising of Weather-tightness issues in school property, the new schools programme, the Property Management Information Systems (PMIS) update and IT changes to support Early Childhood Education (ECE) Savings. While the PMIS and ECE bids are both very small (under \$10 million), they are valuable investments that could produce considerable efficiency gains. We recommend a budget constraint of roughly \$140 million to cover these four bids. This will encourage the Minister to prioritise between the requirements of the two larger bids, as well as the marginal smaller bids and capital expenditure that is already being funded within baselines.
28. In addition to the fiscal cost in Budget 2010, the Minister is signalling considerable forward costs. [deleted – confidentiality of advice]
29. It would therefore be useful to meet to discuss these matters in a bilateral. This bilateral could also include consideration of the [deleted – confidentiality of advice] being sought through Vote Communications for school broadband. This would allow a budget constraint for 2010/11 to be set, and the recommendation of further work to manage medium term pressures.

Table 6. Bids to discuss at proposed Education bilateral

ID	Vote	Title	Department		Treasury		Comment
			Capex	Opex	Capex	Opex	
5900	Education	New Schools Building Programme					Support \$140 million across all four bids
5903	Education	Repairing and Replacing Leaky School Buildings					
5904	Education	Redevelop Property Management Information System (PMIS)	7.729	5.736	140	0	
5905	Education	Modifying Funding Systems to Implement Early Childhood Education Savings	3.91	3.012		0	
5908	Communications	Ultra-fast broadband and schools				0	Support but could scale

[sections in the above table deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]

6) Health

Emerging Risks in Managing Health's Operating Allocation and Baseline Alignment Report

30. *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions].*
31. *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions].*
32. The biggest fiscal risk is that District Health Board (DHB) deficits will exceed the levels for which deficit support funding is already set aside in Vote Health baselines. There is a high risk that DHBs will not be able make the efficiency gains and savings needed to avoid additional deficits in 2010/11 that will impact on the 2010 operating allowance, the operating balance and debt:
- *[deleted – free and frank]*
 - *[deleted – free and frank]*

 - *[deleted – free and frank]*
 - *[deleted – free and frank]*
33. Further detail of Health's 2010 Budget allocation and *[deleted – free and frank]* is provided in notes attached to this report.
34. Treasury recommends that Budget Ministers:
- Confirm with the Minister of Health as soon as possible, that the amounts agreed to date are the final and binding budget constraint for new Health operating funding in Budget 2010; and
 - Request that the Minister of Health include in his Baseline Alignment report a thorough analysis of Industrial Relations and DHB deficit risks in the sector and how these are to be managed within a balanced Health package, and the level of productivity gains.
35. If Budget Ministers are to consider any further operational funding for Health in Budget 2010 (whether from the \$1.1b operating allowance or from other sources such as cross-government reprioritisation), *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions].*
36. Treasury recommends that Budget Ministers agree that *if* any further increase in Health funding is to be considered for Budget 2010, *[deleted – negotiate without prejudice]* should be held back to manage *[deleted – negotiated without prejudice]* and other risks (preferably held at the centre as an un-appropriated tagged contingency) before any funding is committed to new initiatives.

Capital

37. Treasury recommends:

- that Health receives no new capital funding from the centre;
- that the Budget 2010 Health Capital Envelope only fund clearly desirable capital projects or matters of urgency;
- that all other projects be deferred; and,
- that transfers to capital from the Health operating allocation and 2008/09 operating underspends be allowed, if headroom is available in a balanced baseline alignment package that manages all 2010/11 operating risks.

Background

38. The Health capital system works by Budget Ministers setting an envelope, with joint Ministers of Health and Finance making decisions on individual proposals after vetting by the health capital process. The envelope does not expire at the end of the fiscal year. At any point in time there is a balance of money available in the envelope *[deleted – negotiate without prejudice]* and a list of proposals put forward for consideration *[deleted – negotiate without prejudice]*. The process was interrupted in November 2009 by the MRG, hence the large amount of money and large number of bids outstanding. The advisory process moderates the bids before submission to Ministers; a new health capital process is being developed following Cabinet’s MRG decisions to improve the quality of health capital decision-making.

Health Capital Budget Bid: \$200-220m

39. We agree with the Ministry’s proposed criteria for approving projects while the new health capital process is being developed: low risk/high certainty; few service planning issues; immediate safety; government priorities. The material under “Detailed Costings” is also agreed.
40. Under “Calculating the Health Capital Bid”, we agree with using a “top down” approach to determine the budget constraint, but disagree with the approach used. The Health approach is in four parts:
- \$125m in “sustainable funding” path (annual amount determined by a definition of long-term affordability);
 - \$30m for “priorities”;
 - \$40m for “smoothing the bow wave”; and
 - Approximately \$20m transferred from underspends (depending on operating decisions on underspends).
41. *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*. Also, a meaningful “sustainable funding” path if appropriate would by definition be 100% of the bid.
42. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

43. There isn't a true bow wave of projects. The appearance of a bow wave is created by the greater information available on near-term capital demands, and the 2009 hiatus in approvals.
44. The Minister of Finance has agreed to make \$91.362 million in operating funding available in addition to the Health allocation of \$400 million. This is equal to Health's 2008/09 non-departmental operating underspend and is to be spread over the next four years. Proposals for the application of this funding will be included in Health's Baseline Alignment submission. We expect this will include a proposal to transfer up to \$20 million to capital expenditure. If this is done, it will be beneficial as it will reduce the impact on the operating balance and the 2010 general contingency, and could deliver better value for money than additional operational funding for new initiatives.

Detailed Budget 2010 Capital Envelope Advice

Baseline Funding	\$m	\$m
Capital Envelope (unallocated to specific projects)	\$204.500	
2008/09 Underspends	<u>\$6.672</u>	\$211.172
<i>Less Known Pressures likely to be/already agreed by Ministers</i>		
<i>[deleted – negotiate without prejudice]</i>		\$39.900
Remaining Baseline Funding		<u>\$171.272</u>

45. There is *[deleted – negotiate without prejudice]* unallocated in the health capital envelope. So far, the Ministry has proposed that **\$6.672m** of underspend funding be transferred to capital. This may rise to **approximately \$20m**, as noted above, or more following decisions on operating initiatives. Adding the \$6.672m to the *[deleted – negotiate without prejudice]* already in the Health Capital Envelope gives a minimum of *[deleted – negotiate without prejudice]* of available funding.

Health Capital Pressures

46. Subtracting the *[deleted – negotiate without prejudice]* proposals (total **\$39.9m**) from the \$211.172m leaves a minimum of \$171.272 available for other projects. The number of health capital projects approved varies from year to year. Putting the \$171.272m available funding into context:
- The average annual central funding of health capital projects has been around \$140 million over the last ten years; and
 - Over the last ten years, only in 2001, 2003 and 2008 have health capital project approvals required more than \$171.172m of central funding.

47. Applying the Ministry's criteria (low risk/high certainty; few service planning issues; immediate safety; government priorities) and recognising the embryonic state of the new capital process, \$171m will be sufficient to meet 2010/2011 decisions.
[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].

ANNEX A: RISKS IN THE DEVELOPMENT OF HEALTH'S 2010 BUDGET PACKAGE

– OPERATING EXPENDITURE AND BASELINE ALIGNMENT

Available Funding for Health

Health's allocation is \$400m per year...	In December, Cabinet agreed to allocate Vote Health \$400 million in additional operating funding from the Budget 2010 operating allowance. All Health risks, pressures and policy initiatives are to be managed with this allocation, including any increase in DHB deficits above current provisions.
...of which \$350m goes directly to DHBs.	The Minister of Health and Minister of Finance have agreed that \$350 million will be applied to increase funding to District Health Boards through demographic and price changes in DHB appropriations. DHBs were informed of this in funding notices sent before Christmas. As in previous years, this applies an "efficiency adjuster" to DHB funding – reducing funding adjustments below "full FFT/Demo" funding by an assumed efficiency gain.
An extra \$91m will be available to Health, spread over 4 years.	The Minister of Finance has since agreed that the Minister of Health can add one-off funding of \$91.362 million. This is equal to Health's 2008/09 non-departmental underspend. It is effectively an increase the Health Allocation funded from the remaining Budget 2009 general contingency and the 2010 general contingency. Proposed phasing of this extra funding over the next four years will be outlined in Health's Baseline Alignment submission. We understand the Minister of Health may propose transferring up to \$20 million of this to the Health capital envelope.

Relatively Small Changes in Baselines Would Enable a Balanced Health Package

Options to manage \$515m of pressures with a \$300m allocation were outlined in November.	Health's Detailed Baseline Examination last November identified total pressures of \$515m per year (outlined in the first column of the table below). This included full price and demographic adjustments for DHBs, price and volume adjustments for a prioritised subset of Ministry-managed programmes, and a scaled package of new initiatives. That report, working to an indicative allocation of \$300m required \$215m to be found by scaling back DHB funding increases, scaling back new initiatives and taking other savings and reprioritisation decisions to deliver a balanced Health package.
With \$400m+ of new funding and a lower DHB increase, a relatively small package of savings could balance the health package.	The Ministry of Health's report identified a wide range of savings options in . <i>[deleted – confidentiality of advice].</i> With the Health allocation now increased (to \$400m ongoing plus \$91m spread over 4 years) and the DHB funding increases of \$350m, savings and reprioritisation choices required to fund a Health package of the size outlined in the November 2009 report would be only \$27 million in 2010, rising to \$62 million in outyears.

Savings/Reprioritisation Options Needed for a Balanced Health Package

	Detailed Baseline Examination and Budget Report, November 2009	Current Situation
Item	2010/11	
DHB Price/Volume Pressures	\$403m (full FFT/DEMO with no productivity gains)	\$350m (Notified to DHBs in December)
Price/Volume Pressures for MOH-Managed Services	Up to \$62m	\$62m (scalable)
Govt priorities and initiatives	≈\$50m	\$50m (scalable)
Risk Reserve	\$0	\$0
Indicative Total Pressures	\$515	\$462
Less New Funding Available	\$300m indicative allocation	\$435m \$400m allocation plus 2010/11 portion of extra \$91m
Scaling, savings and reprioritisation required to balance Health package	\$215m	\$27m Rising to ≈\$62m in outyears

[deleted – free and frank advice]

[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]

In agreeing to a Health allocation of \$400 million, Cabinet invited the Minister of Health to provide a progress report to Budget Ministers by 28 January on finalising savings and reprioritisation options to manage the balance of Health pressures and policy priorities in Budget 2010. This report has not yet been received from the Minister of Health's office.

[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]

The progress report was requested so Budget Ministers would have an early signal of whether Health's Baseline Alignment submission would deliver a balanced package that manages all the likely risks and pressures in the Vote. It was also intended to ensure that Cabinet could consider any policy choices needed to realise any savings being relied on to balance the health package before final Budget decisions are taken.

[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]

If any savings or reprioritisation proposals are provided, they are likely to be small relative to the overall size of Vote Health (\$13 billion), and to the more discretionary components of Health baselines (\$3.3 billion not distributed to DHBs though population based funding).

[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]

Key risks and pressures in Vote Health

DHBs will have to achieve significant productivity gains to manage within their current funding track.

The \$350m funding increase announced for DHBs implies that DHBs will need to achieve "bankable" savings and efficiency gains if DHB sector deficits are not to exceed the amount already provisioned for in Health baselines. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*

[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]

[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions].

[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]

[deleted – free and frank]

The Health package for 2010/11 outlined in November included no funding for a risk reserve to manage potential issues such as public health emergencies, with these risks to be managed instead through more active baseline management, reprioritisation and reallocation of underspends.

[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]

[deleted – negotiate without prejudice]