

Hon Tony Ryall
Minister of Health
Minister of State Services
Parliament Buildings
WELLINGTON

Dear Tony,

As outlined in the *Budget 2010: Indicative Share of the Operating Allowance* Cabinet paper discussed on 2 November, I committed to write to you providing further details to assist you for the remainder of the 2010 Budget process.

You are aware that we continue to face a tight economic and fiscal environment, where the need for restraint is still necessary. Departments have received significant baseline increases over the last few years, so Vote Ministers are encouraged to look at current baselines as the first source of funding for any new priorities, or should existing programmes require increased funding.

As agreed by Cabinet, your indicative operating allocation for Budget 2010 is as follows:

- Vote Health: \$300 million
- Vote State Services: \$0 million

I should mention that the indicative allocations outlined in this letter could potentially differ from those that we finally agree for Budget 2010. There are a number of factors that may influence the final allocations, such as:

- The detailed examination of various social sector Votes' baselines. Currently, as agreed by Cabinet on 2 November, the requirement to complete a detailed examination of the baselines only applies to Votes Education, Health, Social Development and Justice sector Votes¹. The objective of the detailed examination of these Votes is to ensure that these Votes can deliver priorities within their current baselines and any indicative allocation;
- The fact that some Votes may not be able to deliver on their priorities within existing baselines and may write to me seeking increased funding after carrying out a detailed examination of their Vote's baselines, in line with that expected of the social sector Votes;
- Should a Vote Minister be successful in their request for additional funding, this funding will necessarily result in either existing indicative allocations being reduced, or the reduction of centrally held provisions, e.g. the between Budget contingency;
- Ministers' feedback and their progress in aligning their baselines with priorities; and
- *[Deleted in order to maintain the effective conduct of public affairs through the free and frank expressions of opinions].*

¹ Justice Votes: Attorney-General, Courts, Corrections, Justice, Police and Serious Fraud.

Detailed Examination of Social Sector Votes

Cabinet agreed to a *detailed examination* of the social sector Votes to determine how well they are placed to meet the challenges and expectations in their areas. These reviews are to be completed by 21 December 2009, unless the respective Vote Minister determines that additional funding will be required. In this case, the respective review needs to be completed by 30 November 2009. The detailed examinations are to be conducted by the Vote Minister and department concerned, but Vote Ministers may ask me for supplementary assistance from the Treasury.

The detailed examination of these Votes should include a reconciliation of where baseline increases have been applied in each Vote and what value has been obtained Treasury has developed a terms of reference of the essential information that Vote Ministers must include in the detailed examination of baselines. The terms of reference are attached to this letter.

Process for All Other Votes

The indicative funding allocations agreed by Cabinet mean that the majority of Ministers will not receive any *new* marginal funding increases through this process. Given the substantive baseline increases over the last few years for the majority of Votes, Ministers will be expected to reprioritise from existing baselines to find savings that can be used to manage pressures and achieve their priorities from existing funding.

Vote Ministers should use their baselines to meet their highest priorities. However, there may be instances where some low priority, but still valuable programmes cannot be funded from baselines. In these cases, Vote Ministers are invited to submit to me a request for additional funding, accompanied by a detailed examination of their Vote consistent with those requested of the social sector Votes, by 30 November. This will allow Cabinet to consider these proposals and agree any changes to baselines prior to Christmas.

Baseline Alignment Proposal

All Vote Ministers, including those who will be completing a detailed examination of their Votes at the end of 2009, must submit a Baseline Alignment Proposal by 8 March 2010. This proposal shows how the baseline will be used to meet priorities, detailing any changes that need to be made. These submissions will be considered by Budget Ministers to prepare the final Budget Cabinet paper. More information on how these proposals should be put together will appear in the Budget guidance released by Treasury. The template will be loaded on CFISnet and will be attached to the guidance.

Increases in Policy Capability

One area of spending where I would encourage you to focus on is policy advice. Full Time Equivalent employees in the public service have increased by 10,351 between 2003 and 2008. It is reasonable to assume that a proportion of these are policy advisors.

For your departments, the percentage increase in staff numbers between 2003 and 2008 has been:

- Health: 42%

- State Services Commission: 51%

Individual departments have information on their increases in both numbers of policy advisors and analysts and the cost of policy advice. Vote Ministers may want to ask their departments about growth in the number and cost of policy advisors.

Questions that you may want to ask are:

- How much does the department spend on policy advice?
 - What is the trend information on this spending since 2003?
 - What percentage is this of the total *departmental* spend? (i.e. excluding non-departmental appropriations)
 - Has the percentage changed since 2003?
- How many FTEs are dedicated to policy advice? How has this number changed since 2003?
- Has there been a commensurate increase in the quantity/quality of policy advice over this time and do you need to continue purchasing the same quality/quantity of policy advice?

Savings

The general rule for savings is that they can be retained in a Vote to manage pressures and achieve Ministerial priorities. However, there are two refinements to this rule:

- If a saving is generated by reducing or stopping a major programme or activity, it requires Cabinet approval. Cabinet will determine the proportion of the saving to be retained within the Vote and that to be returned to the centre.
- Where a saving has been generated by efficiency improvements or where a Vote Minister has actively decided to reduce or stop a programme or activity, the saving can be retained in the Vote. Where active management decisions to stop programmes or activities have not been taken, such as underspends from reduced volume or demand, these savings are to be returned to the centre.

Capital

A similar process will be run for capital as in Budget 2009. This will involve Ministers submitting business cases for investment against our stated aim of using improvements in national infrastructure to drive productivity growth. At this early stage, there are a number of large commitments which will be difficult to fit within the capital allowance of \$1.45 billion. This will put a premium on finding innovative ways to manage our balance sheets and deliver services.

Guidance

Treasury will release the Budget 2010 guidance for departments, which outlines in detail how the process will work and the expectations on departments. This guide will be available both on the CFISnet and the Treasury website.

Yours sincerely

Hon Bill English
Minister of Finance

Cc:
Mr Stephen McKernan – Chief Executive and Director General of Health
Mr Iain Rennie – Chief Executive and State Services Commissioner

Terms of Reference for Detailed Examination of Vote Health

Cabinet has agreed to an indicative Health allocation for Budget 2010 of \$300 million per year as the maximum level of the additional funding available in addition to existing annual baselines.

In managing to this allocation:

- All costs that will impact on the Crown's Operating Balance need to be managed within the value of existing annual baselines and the allocation;
- The indicative allocation is the maximum for average annual net increases in operating baselines within the 4-year forecast period for Budget 2010, and the upper limit for net baseline increases beyond the 4-year forecast period.

The Ministry of Health is to undertake a detailed examination of the priorities, pressures and existing expenditure in Vote Health to assist in aligning baselines to Government priorities and, where appropriate, identify where additional resource should be directed.

The Minister of Health is to submit this review to Budget Ministers via the Minister of Finance:

- By **21 December 2009**; or
- If he wishes to make a case that additional funding over and above the indicative allocation of \$300m per year is required, by **30 November 2009**.

This earlier date applies if the Minister of Health wishes to request any additional funding that impacts on the Crown's operating balance or debt, including any request to carry forward any underspends from 2009/10 in a manner other than the expense and capital transfers (ECTs) provided for in the new guidance for changes to baselines approved by Cabinet in September [CO (09) 6].

Given the expectation that a DHB funding signal will be agreed by Cabinet and communicated to the sector in December for planning purposes, the Health review may need to be completed by 30 November in any case.

Terms of Reference:

The following terms of reference apply for all Ministers conducting reviews of their Votes including Vote Health:

- Detail how all increases to the Vote since 2005 have been applied and what value has been obtained from that additional expenditure;
- Demonstrate that they have reviewed all areas of expenditure within the Vote and identified any that are not consistent with this government's priorities;
- Demonstrate how pressures facing the Vote will be handled within the funding available to the Vote (or demonstrate that they cannot be handled within the funding available);

- Demonstrate that they have reviewed the number of policy advisors in and the cost of policy advice provided by their department(s) and whether some reduction in that number or cost can be made; and
- Demonstrate that any fiscal savings expected as a result of the department implementing its performance improvement actions have been taken into account.

Specific implications and issues for Vote Health

In delivering on these terms of reference, the Health review should focus on the trade-offs and options to ensure that the pressures of DHB funding and deficits, and any new initiatives can be managed with the funding available to Vote Health in 2010, and how this can be sustained under a lower funding growth path for the foreseeable future.

The information required for this review will build on work undertaken for the Ministerial Review Group and for the Ministry's ongoing work programmes including the Budget 2009 line-by-line review and ongoing line-by-line reviews, the *Living Within our Means* project, in-depth spending reviews of non-departmental expenses managed by the Ministry, and the *Hospital Productivity Roadmap*.

The key budget priority in Vote Health will be DHB funding and deficits. Decisions about funding increases for DHBs need to be informed by analysis on the adjustments DHBs can reasonably take to manage pressures and about what change can be achieved to provide bankable gains for Budget 2010.

Before any new funding or savings from reprioritisation are applied to other pressures or new initiatives, this review should describe a strategy to ensure that the overall operating impact of DHB funding (FFT and Demo, less any "efficiency adjusters") and DHB deficits will be contained within the amount of funding available to Vote Health. This may involve a mix of up-front DHB funding increases and an appropriation to manage DHB deficits. It will also require a mix of pressure and flexibility for DHBs to operate within their available funding.

While meeting the requirement for historical analysis of expenditure patterns and outcomes, the Ministry of Health should focus its effort for this review predominantly on forward looking issues such as strategies to manage within a significantly lower future growth path rather than on undertaking any extensive new analysis of historical trends.

Expenditure trend information should be provided at the level of appropriations (not a detailed analysis of the 21 individual DHBs' expenditure), supplemented by an analysis of expenditure and performance trends for key categories of health expenditure cut across multiple appropriations in Vote Health (e.g., primary health care).

Terms of Reference for Detailed Examination of any Other Vote for which Additional Funding is being Sought

The Vote Minister will need to:

- Detail how all increases to the Vote since 2005 have been applied and what value has been obtained from that additional expenditure;
- Demonstrate that they have reviewed all areas of expenditure within the Vote and identified any that are not consistent with this government's priorities;
- Demonstrate that they are unable to handle the pressures facing the Vote from within the funding available to the Vote;
- Demonstrate that they have reviewed the number of policy advisors in, and cost of policy advice provided by, their department(s) and whether some reduction in that number or cost can be made; and

Demonstrate that any fiscal savings expected as a result of the department implementing its performance improvement actions have been taken into account.