

## Treasury Report: Illustrative Options for Vote Health in Budget 2010

<b>Date:</b>	25 August 2009	<b>Report No:</b>	T2009/1985
--------------	----------------	-------------------	------------

### Action Sought

	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Bill English)	<p><b>Note</b> the illustrative scenarios for Vote Health Budget 2010 packages from \$200 to \$400 million;</p> <p><b>Forward</b> a copy of this report to the Minister of Health as the basis for early Budget 2010 engagement.</p>	End of August

### Contact for Telephone Discussion (if required)

<b>Name</b>	<b>Position</b>	<b>Telephone</b>		<b>1st Contact</b>
[withheld - privacy]	Analyst, Health	[withheld - privacy]	[withheld - privacy]	✓
Rienk Asscher	Acting Manager, Health	[withheld - privacy]		

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

Forward a copy of this report to the Minister of Health and arrange a September meeting between Ministers if the Minister of Finance agrees
---

**Enclosure: Yes**

## **Treasury Report: Illustrative Options for Vote Health in Budget 2010**

---

### **Executive Summary**

---

Under \$1.1 billion Operating Allowances, a growth range of only 2-3.5% appears to represent what will be fiscally sustainable for Vote Health over the next 10 years. This range compares with a growth rate of 5.9% in Budget 2009, which was the lowest for several years.

This paper provides a series of illustrative Budget options for Vote Health in the \$200 million to \$400 million new funding range. Treasury judgements about the viability of these scenarios are based on initial assessments of available information (see table over page). Treasury considers that the \$200-\$400 million range is sustainable and appropriate for the next three Budgets given the \$1.1 billion allowances and anticipated sector pressures and performance improvements. Ministers will have choices about specific levels in each Budget.

The major pressure to be addressed in Budget 2010 for health is DHB FFT and Demo – currently forecast to be \$365 million. A lower increase than the \$365 million is both possible and desirable as a way of shifting expectations regarding future growth paths. However, decisions about lower funding increases need to be informed by better analysis on the adjustments DHBs can reasonably take to manage pressures and realism about what change can be achieved to provide bankable gains for Budget 2010.

Treasury's initial assessment is that a \$400 million increase for health would allow the Government to meet sector pressures and advance priorities without requiring Ministers to make significant savings choices and/or with only limited significant performance improvement activity. Given the expected pressures within the \$1.1 billion allowance, Treasury considers that \$400 million should be treated as an absolute maximum increase for scenario development in initial Budget discussions.

Treasury considers that an increase of around \$300 million in health spending is an achievable and more fiscally appropriate target for early Budget 2010 discussions, but funding at this level or lower would require Ministers to make choices about savings or performance improvement actions.

The Ministry of Health has an extensive work programme underway (*Living Within our Means* and the *Hospital Productivity Roadmap*) aimed at identifying actions to control costs, improve productivity and manage to a lower growth rate. Treasury supports this goal, but has yet to see any details of practical options that would provide assurances about bankable gains for Budget 2010. Similarly, neither the MRG nor the Ministry have visibly advanced the identification of savings for Budget 2010 since the February 5 line-by-line review, though a number of in-depth reviews are now starting. Developing proposals for improving DHB planning, monitoring and accountability tools for 2010/11 should be a concurrent priority.

Treasury recommends that you forward a copy of this report to the Minister of Health as a way of beginning engagement (and ensuring sufficient urgency and focus of activity) on the realistic options for managing health sector pressures and priorities in Budget 2010. Treasury and the Ministry of Health could work together to provide further analysis of Budget options in the \$200 to \$400 million range to inform a meeting with the Minister of Health in mid September ahead of the October Premier House discussions.

Any decisions about actual new funding in Vote Health should be taken after more informed consideration of pressures and priorities across the entire state sector (including fiscal objectives). Treasury has previously advised you on Budget process options.

**Table 1: Illustrative Options for Vote Health in Budget 2010:** (Note: FFT and Demo not applied to Ministry managed baselines that do not face demand and price pressure equivalent to DHBs.)

Budget Scenarios		Pressure funded	Funding remaining (Funding gap)	Savings/new spending implications	DHB implications
"Net" \$400m	Savings weighted	FFT and Demo with 0.5% efficiency adjustor: - <b>\$315m for DHBs</b> - <b>\$35m for pressure within Ministry managed baselines</b>	\$50m	Some savings from Ministry-controlled baselines or discrete programmes within DHBs may be required for Ministers priorities	<b>Living within \$315m would require</b> - Delivery on promised DHB line by line reviews - Some efficiency savings <u>Risks</u> - <i>[deleted – negotiate without prejudice]</i>
	Productivity/efficiency gain weighted	FFT and Demo with no CPI/LCI component to FFT: - <b>\$215m for DHBs</b> - <b>\$25m for pressure within Ministry-managed baselines</b>	\$160m	No savings required. \$160m would be sufficient for Ministers priorities	<b>Living within \$215m would require</b> - <i>[deleted – negotiate without prejudice]</i> - Much larger DHB line by line and efficiency level savings <u>Risks</u> - <i>Difficult without modest IR settlement.</i> - <i>Risk of deficit growth</i>
"Net" \$200m	Savings weighted	FFT and Demo with 1% efficiency adjustor: - <b>\$270m for DHBs</b> - <b>\$25m for pressure within Ministry-managed baselines</b>	(\$95m)	\$95m savings from Ministry-controlled baselines or discrete programmes within DHBs to manage pressures, \$70 million of which would need to be diverted from discrete programmes within DHBs or Ministry-controlled baselines for DHB pressure. Additional savings would be needed for Ministers priorities	<b>Living within \$270m would require</b> - Some DHB line-by-line and efficiency savings - Low or close to 0% IR settlements <u>Risks</u> - <i>Moderate risk of deficits rising</i>
	Productivity/efficiency gain weighted	Demo only, no FFT: - <b>\$165m for DHBs</b> - <b>\$20m for pressure within Ministry-managed baselines</b>	\$15m	Some savings would likely be required for Minister's priorities	<b>Living within \$165m would require</b> - IR settlements of 0%, and - Large DHB line by line and efficiency savings. It would be very unlikely DHBs could offset the level of pressure required under this scenario solely with efficiency gains in timeframe <u>Risks</u> - <i>[deleted – negotiate without prejudice]</i>  - <i>[deleted – negotiate without prejudice]</i>

**Scale:** ■ could be achieved with significant trade-offs risky and very challenging ■ could be achieved with trade-offs (assuming no large unforeseen pressures) ■ could be achieved reasonably comfortably with limited trade-offs

## Recommended Action

---

We recommend that you:

- a **Note** the illustrative \$200 to \$400 million health funding options to inform future Budget strategy discussions;
- b **Note** that the options in this report should be read alongside other Treasury advice on Budget process options and macro and fiscal policy objectives;
- c **Note** that the highest funding priority in Vote Health for Budget 2010 is DHB baseline increases;
- d **Note** that officials agree that funding DHBs less than forecast FFT and Demo is appropriate, but further analysis is needed to inform what level is sustainable;
- e **Indicate** if you wish to meet with Treasury officials to discuss these options further prior to a meeting with the Minister of Health;

YES/NO

- f **Invite** the Minister of Health to consider health Budget options associated with new funding levels of between \$200 and \$400 million to inform discussions with yourself at a mid September meeting ahead of Premier House discussions in October;

YES/NO

- g **Agree** that an early signal should be provided to DHBs of reduced FFT and Demo funding for 2010/11 and accompanying expectations as Budget strategy discussions permit;

YES/NO

- h **Forward** a copy of this report to the Minister of Health.

YES/NO

Rienk Asscher  
**Acting Manager, Health  
for Secretary to the Treasury**

Hon Bill English  
**Minister of Finance**

## Treasury Report: Illustrative Options for Vote Health in Budget 2010

---

### Purpose of Report – Informing Budget Strategy

---

1. Budget 2010 and beyond presents a tight fiscal environment. The \$1.1 billion maximum operating allowance (OA) identified by the Government represents a close to CPI only increase (~1.7%) across all Government spending – no ‘real’ increase.
2. This has obvious implications for all Votes for the foreseeable future. For Health this will mean significant reductions in recent growth rates from Budget 2010. With a \$1.1 billion OA, a growth range of only 2-3.5% appears to represent what will be fiscally sustainable over the next 10 years. This range compares with a growth rate of 5.9% in Budget 2009, which was the lowest for several years. While Ministers have choices about the speed and target for transitioning to a lower growth path, choices are limited by commitments to other priority areas and the Government’s fiscal objectives, as well as a need for realism about how quickly the sector can adjust. Nevertheless the timing with regard to public and sector expectations supports aiming for a significant growth reduction in Budget 2010.
3. You commissioned a report on health options under low, medium and high Budget 2010 funding scenarios at your 1 July meeting with the Minister of Health. This paper provides an initial indication of pressures and priorities in Budget 2010 alongside an early assessment of the options for mitigating these and identifying savings. This is intended to:
  - Inform expectations about the magnitude of pressures, priorities and savings choices that may be required in Budget 2010;
  - Support pre-Budget analysis of the actions that can deliver the necessary performance shifts and savings in time for Budget 2010 to inform which options are viable.
4. The first of these intentions is achieved by a relatively simple tabulation of known pressures and priorities against available funding to create different scenarios. Providing reliable information and analysis about the credibility of strategies that will provide the required benefits is much more difficult and is not achieved in this report. The report instead emphasises the importance of progressing this analysis to provide Ministers with confidence about the impact of their Budget 2010 decisions.
5. The Ministry’s *Living Within Our Means* (LWOM) report has provided a conceptual basis for advancing work to assist the sector in sustainably managing to a lower growth path. This paper aims to advance the analysis undertaken by the Ministry by setting out a concrete discussion on the specific improvements and savings that would realistically need to be advanced under different new spending levels for Budget 2010. In most areas our analysis of realisable savings and performance improvement actions is at an early stage and therefore judgements about the viability of different scenarios are only interim to inform Ministers’ expectations and discussions.
6. The Ministry of Health has been consulted on an earlier draft of this report, but chose not to comment on the Treasury’s illustrative Budget scenarios at this time. The Ministry has an extensive work programme underway (outlined in LWOM and the PIA presentation to be discussed at ECC) and expects to be in a position to inform further options analysis from early October.
7. Treasury recommends that you use the scenarios in this paper to provide the basis for a discussion with the Minister of Health in September ahead of the wider discussions of Budget strategy, priorities and options at Premier House. A clearer sense of relative pressures, priorities and opportunities can inform funding decisions (both health and

wider state sector), in turn informing discussions about the optimal Budget and vote arrangements (for all votes).

8. This paper does not seek any decisions from Ministers on Budget 2010 at this time, but does signal some areas where analysis needs to be advanced and where decisions will likely need to be taken in advance of Budget 2010 (e.g. DHB FFT and Demo signal for 2010/11).

## Approach to Budget 2010 – Health Pressures and Priorities

---

9. For Vote Health, Budget 2010 will be about balancing the need to sustainably address health sector pressures and the desire to advance Government priorities, against the risk of Health spending crowding out other priority areas in a tight fiscal environment.
10. The Health sector is conditioned to running on nearly automatic FFT and Demo increases. Simply rolling over current expectations and taking no further action would present Ministers with a ~\$365 million bill to broadly stand still (plus up to ~\$96 million for pressures on Ministry controlled NDEs).<sup>1</sup> In addition there are approximately \$65 to \$95 million worth of Government priorities left over from Budget 09 (depending on the treatment of electives and phasing choices). This situation frames the approach to Budget 2010 options.
11. Budget 2010 choices for Health require information on two broad questions:
  - What is the lowest range for DHB/MoH services funding increases with what implications/impacts?
  - What savings can be achieved within Vote Health baselines to offset new funding sought to address pressures and advance priorities thereby minimising the impact on the Operating Allowance?
12. As a way of advancing the transition to a lower growth path, Treasury considers that it is possible and appropriate to fund DHBs at less than forecast FFT and Demo in Budget 2010, but it is an open question how much of a reduction is prudent. 'Underfunding' DHBs increases the risk of deficit growth and/or service impacts such as increased waiting times. The level of any 'efficiency' adjustor employed to reduce DHB funding will need to be informed by a realistic assessment of the actions that will provide bankable savings in the sector and which are realisable in 2010/11. Under any Budget 2010 scenario, DHB pressures are likely to require the majority of any new funding, and may even exceed available funding under some Budget scenarios.
13. Ideally, headroom to advance Government priorities in health can be created through successful productivity and efficiency improvements (doing things better) that reduce funding requirements or otherwise free-up resources. However, the bankable gains realisable in time for Budget 2010 may be limited, in which case Government priorities requiring new funding may need to be purchased through disinvestment or other savings decisions. An early and realistic assessment of the bankable returns from performance improvement actions and the early identification of areas of lower value expenditure that could release savings will be needed to inform Ministers' Budget 2010 options.
14. Performance improvement and active baseline management will be important in the ongoing management of expenditure growth in the health sector. However, given adjustment times and questionable readiness of actions to support productivity and other performance improvements, the primary tool for managing Vote Health in Budget 2010 may be savings (depending on the funding scenario).

---

<sup>1</sup> Source: 26 June figures from the Ministry of Health FFT 2.075%, Demo 1.692%

## Budget Options

---

15. Treasury has prepared several high level Budget 2010 packages for Health based on different net-funding impacts (i.e. net new funding from OA after savings offered back or retained in Vote). [See table on page 3]. For each funding level, an option is presented that puts emphasis on managing through reductions to new DHB funding on the assumption of productivity and efficiency gains. The other option puts more emphasis on identifying savings to be reprioritised to other services (as in the Budget 2009 line-by-line review).
16. An assessment of these options (or alternatives) can be informed by assessments about the sector's ability to adjust to less than forecast new funding in 2010/11 and the savings opportunities available in the same period. Treasury has provided initial assessments of the nature of trade-offs required for these options (from comfortable to challenging), but this assessment is based on initial analysis of limited information and should be subject to further analysis and advice from the Ministry.
17. While all scenarios present significant reductions on the \$750 million allocations of recent Budgets, the initial scenarios suggest that a \$400 million increase could be relatively comfortably managed with limited active savings or performance improvement actions. The application of a 0.5% efficiency to the DHB funding growth rate and an inflation only increase across Ministry NDEs would leave \$50 million for advancing Government priorities before any savings decisions were advanced (either policy choices or price-quantity-standard trade-offs). Any further bankable gains would increase headroom for Government priorities. Given the expected pressure within the \$1.1 billion allowance, Treasury considers that \$400 million should be treated as an absolute maximum increase for scenario development in initial Budget discussions.
18. Lower funding scenarios, which may be required or desirable when looking at overall Government choices, can be pursued if supported by Ministers' appetite for change, willingness to reprioritise lower value expenditure and/or confidence in the sector's ability to deliver performance shifts in the timeframes.
19. The Ministry's LWOM work estimates [*deleted – negotiate without prejudice*] is realisable in 2010/11 from 'improvements in productivity, performance and quality' that would offset DHB funding pressures. While supportive of the need for performance improvements, Treasury has yet to see any practical assurances that this level of saving is achievable in 2010/11. Disinvestment and other savings decisions which carry certainty about gains are likely to provide a better option for managing to lower increases than large DHB funding reductions with uncertain impacts.
20. Initial assessments suggest that there could be a manageable Budget scenario around \$300 million for health that would be difficult but achievable, representing an appropriate target in the current fiscal situation (if the Government has moderate fiscal consolidation goals). [*information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials*]. Further analysis will allow officials to test this and other characterisations of Budget scenarios ahead of any Ministerial decisions.

## Informing Budget Choices – focusing further pre-Budget analysis

---

21. As stated (para 3), improving information and analysis about specific actions or adjustments to support Ministers confidence about the impacts of Budget decisions is the more difficult pre-Budget task. It is also the key to making funding scenarios such as \$300 million or lower (or even \$400 million or above depending on Government priorities) viable options and therefore needs to be the focus for the current phase of pre-Budget analysis. Treasury recommends that you discuss progress on providing these assurances at a September meeting with the Minister of Health and officials.

22. Some relevant questions, comments and initial assessments (all requiring further analysis) are unpacked in the attached Appendix to inform your understanding of the judgements Treasury has brought to the scenarios. These considerations should also serve as the basis for a discussion on the realisable gains for Budget 2010 at the September meeting.

## Next Steps

---

23. Ministers should retain flexibility around Budget 2010 funding decisions as long as possible, but an earlier signal of likely funding parameters will help the Ministry and sector get an early handle on the level of yield expected from existing resources thereby informing tradeoffs.
24. We recommend that you forward this report to the Minister of Health and invite him to start developing some scenarios of the options presented by Vote Health new funding in the range of \$200 to \$400 million. This could form the basis for a meeting in mid September ahead of the Premier House Budget strategy discussions. This meeting would allow:
- an early assessment of the realistic options and trade-offs anticipated in health to inform similar considerations across other major sectors and priority areas;<sup>2</sup>
  - assurances that Budget 2010 work programmes regarding savings and productivity improvements were on track to deliver timely assurances (covering the analysis questions above);
  - discussion of the improvements being made to the DHB planning and accountability framework and internal Ministry purchase functions to promote and support adjustment in the sector;
  - early consideration of an early signal to DHBs to expect the application of efficiency adjustors to 2010/11 funding to allow expectations adjustment ahead of the usual funding signal in December;
  - consideration of the best approach to an FFT signal given the potential impacts on upcoming workforce bargaining (RMO negotiations begin in November).
25. The Ministry is continuing to advance the LWOM work programme with a focus on the cost control and savings options that can be sufficiently advanced to provide assurances the nature of the savings that can be delivered for Budget 2010.
26. The Ministry has signalled that it considers clarification of the future Vote Arrangements as important to its Budget 2010 preparation. The Ministry's Performance Improvement Actions signal a report back on options to Ministers in September. Treasury does not agree that the arrangements are material to consideration of the early Budget options and recommends that these are not a priority issue for any September meeting. While the arrangements have been useful, we assert that the management of risks within the Vote in recent years has been more a result of the allocation size rather than the rules themselves.<sup>3</sup> We will provide further analysis to support a discussion when it does take place.

---

<sup>2</sup> A similar approach of early engagement is recommended for other significant areas such as education and the justice sector.

<sup>3</sup> The previous Health Funding Package arrangements were actually more flexible (three year appropriated funding path), but did not contain health pressures.



## Appendix 1: Informing Budget Choices – focusing further pre-Budget analysis

### DHB funding pressures

27. The application of any efficiency adjustor to DHB funding needs to be supported by a realistic appraisal of how DHBs could manage pressures. If misjudged, an efficiency adjustor that is too high can lead to greater deficits or impact on service delivery (e.g. increased waiting lists).
28. *How much impact are the lower inflation and FFT forecasts expected to have on forecast 2010/11 DHB deficits?*  
Current 2010/11 plans (from 2009 DAPs) *[deleted – free and frank]* and appear to be largely based on a straight application of adjustor to expenditure areas. Assuming that this represents costs that are broadly correlated with inflation, there should be minimal impact on planned deficits.
29. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*
  
30. *What are the specific practical actions that will provide ‘cash releasing’ DHB productivity and efficiency gains for Budget 2010?*  
LWOM and the Hospital Productivity Roadmap have identified some targets for 2010/11 – procurement \$50 million, shared back office \$25 million, *[deleted – confidentiality of advice]*.<sup>4</sup> While Treasury is strongly supportive of these goals, careful consideration needs to be given to these claims and the ability of the sector to deliver them in 2010/11. To date the analysis we have seen has been fairly conceptual and has not identified the specific actions that will be taken to deliver the identified gains, allow the DHBs to capture them and overcome the barriers identified by previous attempts. Nor has any uncertainty analysis been provided. *[deleted – free and frank]*  
<sup>5</sup> Many of the productivity initiatives identified are already underway in some DHBs, but do not appear to have a large impact on forecast performance.
31. *What are the specific co-requisites, such as improvements to internal and external accountability arrangements for these shifts to work?*  
This could include greater upfront challenge of planned DHB expenditure increases (relaxed for traditional good performers) and a greater focus on performance and productivity measurement and improvement. The Ministry will need to have planning and monitoring documentation that allows better understanding of the impacts that lower funding is having and how DHBs are managing pressures to better inform future decisions and ensure sustainable responses. The conditionality placed on the 2009 DAPs and the upcoming 2010/11 planning round provide important opportunities to pursue these shifts.

---

<sup>4</sup> HR20091127, *Living Within our Means* – Annex 2

<sup>5</sup> The development of procurement and shared services agencies are also key features of the MRG recommendations. Officials have identified these as areas to kick-start analysis now about the best ways to benchmark and realise the potential gains from shared services and procurement.

32. *Is Budget 2010 the best opportunity to set tighter constraints on new sector funding?*  
It is not likely that there will be a 1:1 correlation between lower funding and higher deficits as at least some pressure will be absorbed. Pushing harder on DHB funding levels may improve understanding of impacts for future decisions. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*

### **Savings opportunities**

33. *What level of savings is achievable for Budget 2010?*  
*[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

*Graph: Illustrative savings options*  
*[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

34. *Should the identification of programmes that could be exited for Budget 2010 be a secondary concern to performance improvement for Budget 2010?*  
The role of savings from Vote Health in Budget 2010 (such as lower value programme disinvestment or gains from price-quantity-standard tradeoffs) should not be ruled out at this time. Not progressing savings options now may limit options to progress priorities if expected DHB productivity and efficiency improvements are not achievable. While there is a rationale for pursuing disinvestment decisions only after other means of meeting pressures have been exhausted, there is a strong case that reprioritisation of lower value expenditure and promoting more efficient and cost-effective delivery of services should be an ongoing focus no matter what the fiscal environment.

### **New initiatives/Government priorities**

35. *What is the impact of advancing Government priorities on other desired shifts in the sector?*  
Ring-fencing portions of FFT and Demo funding to advance Government priorities reduces the net cost, but risks decreasing DHB flexibility to respond to overall pressures – particularly if significant efficiency adjusters are also being applied. The sector will need to focus on driving performance shifts in 2010/11 and beyond, and pressure to implement additional new programmes or policies will need to be considered in light of the impact it may have on performance improvement programmes. For example, realism needs to be brought to the consideration of the level of electives volumes that are achievable, from both a fiscal perspective

*[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]* and from a delivery perspective *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*.

### **Capital funding pressures**

36. Capital funding has not been directly considered in this report. While capital pressures are also a concern for Budget 2010 and beyond, the most pressing issue is to improve the quality of capital proposals and longer-term service integration. It is important to maintain pressure on the health capital envelope to achieve this and while some capital increase is recommended, maximum capital increases should be limited to \$100 million to \$150 million which is sufficient to meet highest priority projects.