

The Treasury

Budget 2013 Information Release

Release Document

July 2013

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Treasury Report: Budget 2013: Strategy for Vote Health

Date:	27 November 2012	Report No:	T2012/2517
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Note Cabinet's priorities for Health's Four-Year Plan Confirm your support for our priorities when engaging with the Ministry of Health Refer this report to the Minister of Health	4 December 2012

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
[3]	Analyst	[3]	✓
Ruth Isaac	Manager, Health & Housing		

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury
Refer to the Minister of Health

Enclosure: No

Treasury Report: Budget 2013: Strategy for Vote Health

Executive Summary

The purpose of this report is to provide information on Vote Health issues that are likely to require your attention during the Budget 2013 process. It informs you of key decision-making dates, the Treasury's priorities in Vote Health in the Budget process, and seeks confirmation that these areas are aligned with your priorities.

Communications

This report does not raise communication issues.

Recommended Action

We recommend that you:

- a **note** that on 27 August 2012¹, Cabinet:
 - i. **agreed** that departments are required to identify savings options to ensure a timely return to surplus, should the fiscal forecasts significantly weaken;
 - ii. **agreed** that Four-Year Plans for Budget 2013 will have a stronger performance and risk management focus than in previous Budgets;
 - iii. **agreed** to an indicative allocation of \$350 million per annum to Health from the operating allowance for Budget 2013;
 - iv. **agreed** to an indicative allocation of \$350 million per annum to Health from the operating allowance for Budget 2014;
 - v. **noted** that Budget Ministers will assess whether the indicative allocation for Health needs to be reviewed, given savings and reprioritisation opportunities, as work on the government's response to the family caregivers case is progressed and the cost of policy options clarified;
 - vi. **noted** that there are likely to be significant capital pressures at Budget 2013, and that this will require careful prioritisation;
- b **confirm** your support for our priorities when engaging with the Ministry of Health, ensuring that:
 - i. the Ministry of Health provides a range of credible efficiency, reprioritisation and savings options to manage pressures in Vote Health;

Agree/disagree.

¹ CAB Min (12) 30/8 refers.

- ii. costings and funding options for policy change following the courts' rulings on employment of family caregivers to provide disability support are robust, and that the policy advice process on this is joined up with the 4YP; and

Agree/disagree.

- iii. the Ministry of Health's 4YP provides advice on options for capital expenditure over the forecast period, including for Budget 2013, and the implications of different capital expenditure paths for the sector; and

Agree/disagree.

- c **refer** this report to the Minister of Health.

Refer/not referred.

Ruth Isaac
Manager, Health & Housing

Hon Bill English
Minister of Finance

Purpose of Report

1. The purpose of this report is to provide information on Vote Health issues that are likely to require your attention during the Budget 2013 process. It informs you of key decision-making dates, the Treasury's priorities in Vote Health in the Budget process, and seeks confirmation that these areas are aligned with your priorities.
2. The Treasury's top priorities are ensuring:
 - the Ministry of Health provides a range of credible savings options to manage pressures in Vote Health;
 - costings and funding options for policy change following the courts' rulings on employment of Family Caregivers to provide disability support are robust, and that the policy advice process on this is joined up with the 4YP; and
 - the Ministry of Health's 4YP provides advice on options for capital expenditure over the forecast period, including for Budget 2013, and the implications of different capital expenditure paths for the sector.

Treasury's Strategy for Vote Health

Health's 4YP will be the key document to inform Budget 2013 decisions relating to Vote Health

3. The Ministry of Health will submit its 4YP on 20 December. Central Agencies will give their advice on the 4YP to Budget Ministers in February. Our expectations are that this document will identify operating pressures in Vote Health over the next four years, and provide Ministers with options to reduce pressures and / or make savings in Vote Health to live within the \$350 million indicative operating allocation. The 4YP should also identify prioritised capital pressures, help Ministers agree on a capital funding allocation, and set out a strategy for improving capital asset management and decision-making.

Ministry of Health will lead work on savings options in Vote Health

4. In the lead up to the last Budget, Treasury took a lead on developing estimates and options for savings from increasing the targeting of primary care and pharmaceuticals. (See Treasury Report T2011/2570, 20 December 2011.) We also provided initial advice on savings that could be made by removing automatic increases to the asset-testing threshold for the aged residential care subsidy. The Ministry of Health took over the lead on this work only late in the Budget process as it became clear further savings would be required to manage Health's budget package.
5. This year we have signalled to the Ministry of Health the expectation that the Ministry's 4YP will offer advice on potential savings options to meet cost pressures, consistent with Cabinet's agreement that agencies and sectors should be prepared to have savings options available to help ensure a timely return to surplus. (CAB Min [12] 30/8 refers.)

6. The Treasury is therefore not currently intending to lead advice on savings options in Health. We will instead work with the Ministry of Health to assist them in assessing savings options for the 4YP.
7. If further savings are required, we can reprioritise our work to develop additional savings options should you wish to commission this work. The nature, degree and scale of this advice will depend on what is covered in the 4YP.

Pressures

8. The Treasury has signalled a clear expectation that the Ministry should develop a more detailed depiction of cost pressures in Vote Health. This includes information on bottom-up cost pressures in the health sector, a description of the pressure that any changes to Health Targets and other initiatives place on DHBs, funding allocation decisions among DHBs, and key areas of service and financial risk.

Opportunities for deeper understanding of health pressure

9. In previous budget plans and in its SEC presentations, the Ministry has started with a “top down” estimate of cost pressures, derived from the “Future Funding Track” (FFT) and demographic (Demo) demand formulas. These can be a first step to understanding broad cost pressures across the whole of Vote Health, and are useful for the Ministry of Health’s communication to DHBs, assuring DHBs that their demographic changes are accounted for, but that there is an expectation that they control other cost pressures.
10. However, there are risks and limitations in using the FFT and Demo formula to describe pressure in the sector:
 - the Labour Cost Index and Consumer Price Index forecasts used in FFT calculations do not reflect the actual labour and other input cost pressures in the health sector, especially in the short term;
 - the ‘technology adjustor’ in FFT calculations builds in a service expansion expectation;
 - DHBs have not been funded for “full FFT” since Budget 2009, and have long been expected to fund new services from funding notionally provided to cover cost pressures of current services. [6]
 - so this approach enables affordable funding increases to be framed as an effective funding “shortfall” compared to FFT (or alternatively as the productivity gap that is required); and
 - without adjustments, FFT and Demo ignore the costs of service expansion pressures such as increased Health targets.
11. There are practical reasons why bottom-up forecasts are difficult to develop into a full assessment of pressure in the sector. Yet there are existing data that the 4YP can draw on to describe bottom-up pressures in a way that complements the top-down FFT and Demo measurement. DHBs have provided detailed financial information until 2014/15 as part of the Annual Plan process. Additionally, every major Multi-Employer Collective Agreement (MECA) between DHBs and unions is currently settled. Some MECAs, such as the New Zealand Nurses Organisation MECA, are active until March 2015. These are just two sources of information that provide more detailed information on DHBs’ cost pressures to complement CPI- and LCI-based measurements.

12. In the overall 4YP story we would like to see a reframing of health sector funding away from aiming to fill a gap between allocations and FFT plus Demo.
13. To aid this richer story, a stronger focus on productivity gains and service improvements would be useful (since meeting the sector's definition of "real" funding increases is unsustainable). Output- or outcomes-based measurements can show how the sector is increasing its value-for-money and recognise the success of savings initiatives in improving health outcomes at a lower cost. We see the National Health Board is framing its expectations of the DHB sector in these terms.

Health Targets and unfunded initiatives

14. The six national Health Targets have, in general, been successful at improving DHB performance in key service areas. In recent years DHBs have been expected to meet more demanding targets and to expand some other services within baselines and from the annual adjustment to their population-based funding. This necessarily involves trade-offs within DHBs as resources are shifted away from other areas and/or operating surpluses (deficits) are reduced (increased).
15. We understand the Minister of Health has signalled that Budget 2013 is likely to see much less in the way of unfunded additional services expected of DHBs, allowing DHBs to focus on managing their current cost pressures within available resources. We would like the Ministry of Health to provide a robust analysis to Ministers on the resource implications to DHBs of setting new targets. The Ministry of Health will advise the Minister of Health on Health targets in December.

District Health Board Funding Signal

16. The DHB funding signal to be agreed by Cabinet in December will provide a basis for DHBs to plan services over the next four years.
17. We understand that Cabinet has agreed that \$250 million of the \$350 million increase indicatively allocated to Health is to be signalled to DHBs as the DHB sector's share. This funding envelope will be tight. The Ministry of Health has updated PBFF shares within the envelope based on new demographic data. A formal funding signal to be sent in late November is to be approved by Joint Ministers.
18. How DHBs' funding is allocated among DHBs is becoming increasingly important. DHBs are allocated funding according to the PBFF which aims to allocate funding among DHBs that recognises variation in costs to deliver services to different demographics and to rural and non-resident patients. We understand that updated demographic projections are leading to some unexpected revenue impacts for DHBs that will need to be managed.
19. Key questions include:
 - What will the impact of these allocations be on DHB deficits?
 - Given slower funding growth, is funding to DHBs with growing populations (e.g., Counties Manukau) adjusting fast enough in comparison to DHBs with declining populations (e.g., Southern DHB) to both address cost pressures and avoid horizontal inequity among DHBs?
20. The lower allocation to DHBs this year underscores the importance of minimising increases in service expectations of DHBs. Increasing DHBs' service provision without also increasing funding puts pressure on DHBs. This cost pressure has been approximated in past Budgets, but is an area that the Treasury is interested in

scrutinising as these initiatives can be implemented without Cabinet approval as new funding is not sought. We understand the Minister of Health wants less pressure on DHBs so we expect the 4YP to reflect this.

21. We expect the 4YP, as well as DHBs' Annual Plans, to outline how this will be managed by the sector, detailing both service risks and risks to the deficit track. We expect commentary in the 4YP on the feasibility of \$250 million increases to baselines per annum over four years. Finally, we expect an outline of options Ministers could consider if DHB savings and productivity improvements are unable to meet pressures.

Family Carers

22. The cost of policy changes for home-based disability support is the most uncertain element of the 2013 Budget process for Vote Health. The courts have ruled that the current policy barring family members from being employed to care for their disabled adult relatives is unlawfully discriminatory. A new policy will need to be implemented in 2013.
23. In agreeing Vote Health's indicative allocation for Budget 2013, Cabinet noted² that:

Budget Ministers will assess whether [this] needs to be reviewed, given savings and reprioritisation opportunities, as work on the government's response to the family caregivers case is progressed and the cost of policy options clarified.
24. The Ministry of Health has recently completed a public consultation process, and is due to report to Cabinet in December with recommendations on a preferred approach. Treasury is engaged in this work alongside other central and social sector agencies, but at this stage we are not confident that officials will be able to deliver final advice with costings and funding options before Christmas.
25. This creates significant risks for management of the Health package for Budget 2013. The 4YP to be delivered in December will not be able to fully reflect the potential cost of family caregivers policy options. What we will be looking for in the 4YP, therefore, is:
 - [6]
 - a full set of options for reprioritisation both within disability support and more broadly across the Vote to part-fund the cost of a policy change;
 - increasingly robust estimates of the cost of policy options – including the potential flow-on costs to DHBs for disability support services they fund; and
 - a timeline for Ministers to take decisions on policy changes including reprioritisation and savings to part-fund the cost of a new policy.
26. [6] In advice provided to Cabinet in September, the cost of different combinations of targeting, caps, and required unpaid hours ranged from [6]

² CAB Min (12) 30/8 refers.

Capital

27. The Treasury reports *Capital Pressures and Priorities for Budget 2013* (T2012/2743) and *Baseline Capital Intentions* (T2012/2833) showed Health sector capital intentions over the next four years. The Treasury report *Health Capital Envelope* (T2012/2612) addressed immediate issues in relation to Health capital.
28. *Capital Pressures and Priorities for Budget 2013* highlighted an approximate [6] Health capital pressure against the Future Investment Fund (FIF) for Budget 2013 and over [6] for Budget 2014. Both of these figures are highly uncertain. Up to [6] is available in the Health Capital Envelope to partially fund these projects.
29. Health's capital bid for Budget 2013 will become clearer when the Christchurch Hospitals Redevelopment Project's Detailed Business Case (DBC) is finalised on 21 December. However, the [6] has emerged as a significant capital pressure.
30. [6]
31. *Baseline Capital Intentions* summarised information from Health's 10-Year Capital Intentions report, and detailed how Health's capital intentions, including those being funded within baselines, align at a high level with Government priorities.
32. Ministers have agreed that most of the Health Capital Envelope be reserved prior to a decision on the Christchurch Hospitals Redevelopment Project, and detailed timing and funding issues with particular capital projects. [7]
33. On 5 December, a Joint Ministers meeting has been scheduled to discuss Health capital pressures, including the capital cost estimate and affordability of the Christchurch Hospitals Redevelopment Project and options for addressing seismic challenges facing the Grey Base Hospital. Additional briefing material will be provided in advance of the meeting.
33. In February 2013 the Treasury will advise on Health's capital pressures, key strategic issues in the sector, and recommend a level of capital expenditure for Budget 2013. This will be informed by the Health's 4YP, and complement further advice on capital expenditure across the whole of government.
34. The Treasury's expectation is that health capital funding decisions will be informed by, at minimum, strategic business cases outlining the necessity and strategic fit of new projects, matching strategic direction for DHB regions and prioritised as a whole. The 4YP should provide advice on options for capital expenditure over the forecast period and the implications of different capital expenditure paths for the sector.
35. An outcome of the 4YP we would like to see is joint work agreed by Ministers for the first half of 2013 on Health's future capital funding options. We think there are real questions about the sustainability of the current approach and a need for greater certainty of future investment levels and priorities for planning purposes. At present

there is little guidance year-to-year to moderate expectations or guide sector transformation.

Miscellaneous Issues

Formal documentation of Ministers' decisions will help ensure Budget advice is consistent

36. In past Budgets, some decisions on the size of allocations, the approval of certain initiatives, and where funding is coming from have been agreed among Ministers without formal documentation of these decisions. This has led to different understandings amongst officials of Budget Ministers' requirements. Documentation, such as agreed minutes, explaining what has been agreed to will ensure that officials work with common knowledge of the state of the Budget.

Cross-Vote Issues

Whole-of-Government Radio Network

37. You have previously received advice on the Whole-of-Government Radio Network (WGRN) detailed business case (DBC) (T2012/2746: *Whole of Government Radio Network Detailed Business Case* refers). The Cabinet paper on the WGRN DBC will seek an agreement in principle to provide funding to Vote Health.
38. On 15 May 2012 the Minister of Health wrote to you seeking confirmation of a verbal agreement on 27 March that the additional costs of a WGRN would not cost the ambulance sector (Votes Health and ACC).
39. Based on this, our assumption is that should new funding be provided, it will be sourced outside of Vote Health's indicative \$350 million allocation if the DBC is approved by Cabinet. The preferred option requires both a \$5.4 million capital investment and \$0.636 million in additional ongoing operating costs for the ambulance sector to run the digital network in Auckland, Wellington and Canterbury. The proposed plan is for this to be the subject of a Budget bid for Vote Health. For administrative simplicity, Vote ACC would not have to fund this increase in operating costs.

Disabled school leavers and other Welfare issues

40. [6]
41. The Treasury continues to extend the expectation the 4YP should develop options to deal with other issues that intersect Health and other sectors. These include drug testing for beneficiaries and any initiatives that affect pharmaceutical subsidies in the Disability Allowance.

Community housing

42. In Budget 2012 Cabinet agreed to provide Vote Housing with \$3.8 million to subsidise community housing utilised by various health clients (CAB Min [12] 13/3[16] refers). Cabinet also agreed that ongoing funding will be found from within Vote Health's baseline following additional policy work led by the Department of Building and Housing in 2012/13, now the Ministry of Building, Innovation and Employment (MBIE). We have inquired into MBIE's progress on this but are yet to have a response. The Ministry of Health has indicated it will address the community housing issue in its 4YP.

Timeline

This timeline sets out key events and decision points relating to the Health Budget.

Date	Event	Action
November 29	DHB funding signal	Joint Ministers approve funding signal to DHBs
December 5	Joint Ministers meeting on Health capital	Discuss Health capital pressures, especially developments in Canterbury DHB and West Coast DHB
December	Minister of Health sets new Health Targets	-
December 18	Half-yearly Economic and Fiscal Update (HYEFU) and Budget Policy Statement (BPS) released	-
December 20	Health submits its 4YP	-
December - January	Family caregivers policy advice due	Agree on changes to the Ministry of Health's family caregivers policies
2013		
February	Central Agencies assess Health's 4YP	Note Central Agencies' advice on Health's 4YP
February	Capital Investment Committee considers the Christchurch Hospitals Redevelopment Project	
March	Cabinet considers the Christchurch Hospitals Redevelopment Project	Approve funding for Crown contribution to Project, including any portion to be funded from the Health Capital Envelope
March – April	SEC paper on key issues over whole-of-government 4YPs	Discuss key Health issues with the Minister of Health and Associate Ministers of Health
March – April	Budget Ministers' decision process	Finalise Budget initiatives and final Health allocation Agree a capital allocation for Health
Mid-April	Budget Cabinet paper	Approve Vote Health's Budget package
Mid-May	Budget day	-
January – June	Continuing joint work on Health's ongoing capital funding path	-