

The Treasury

Budget 2015 Information Release

Release Document July 2015

www.treasury.govt.nz/publications/informationreleases/budget/2015

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

- [1] 6(a) - to prevent prejudice to the security or defence of New Zealand or the international relations of the government
- [2] 6(c) - to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial
- [3] 6(e)(iv) - to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.
- [4] 9(2)(a) - to protect the privacy of natural persons, including deceased people
- [5] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information
- [6] 9(2)(ba)(i) - to prevent prejudice to the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied.
- [6a] 9(2)(ba)(ii) - to protect information, where the making available of the information would be likely otherwise to damage the public interest
- [7] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand
- [8] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials
- [8a] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting the collective and individual ministerial responsibility
- [9] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [10] 9(2)(h) - to maintain legal professional privilege
- [11] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
- [12] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
- [13] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [14] Not in scope

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [4] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Treasury Report: Advice on District Health Board Funding Signal for 2015/16

Date:	28 November 2014	Report No:	T2014/2057
		File Number:	DH-1-2-3-2-4-2014

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	<p>Agree to a \$250 million funding signal for District Health Boards for 2015/16;</p> <p>Agree that the timing of the District Health Board funding signal process be reviewed prior to Budget 2016 so that it can be integrated into wider Budget advice.</p> <p>Discuss the contents of this report at Fiscal Issues on Tuesday 2 December.</p>	Fiscal Issues on Tuesday 2 December
Associate Minister of Finance (Hon Steven Joyce)	Discuss the contents of this report at Fiscal Issues on Tuesday 2 December.	Fiscal Issues on Tuesday 2 December
Associate Minister of Finance (Hon Paula Bennett)	Discuss the contents of this report at Fiscal Issues on Tuesday 2 December.	Fiscal Issues on Tuesday 2 December

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Erin King	Senior Analyst, Health	04 917 6224 (wk)	-	✓
Ben McBride	Manager, Health	04 917 6184 (wk)	[4]	

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

Return the signed report to Treasury.

Enclosure: No

Treasury Report: Advice on District Health Board Funding Signal for 2015/16

Executive Summary

The Minister of Health is planning to seek Cabinet's agreement to provide a funding signal of \$300 million to District Health Boards for the 2015/16 year. He may take a late paper to SEC on 3 December. This is an important decision as it essentially locks in the first major component of the Budget 2015 package.

Ministers have confirmed that the operating allowance for Budgets 2015 and 2016 will be around \$1 billion. Treasury's current working assumption is a total allocation of \$400 million for Vote Health in Budget 2015. Factoring in pressures in other Votes and priorities such as the work on children in material deprivation, the operating allowance is currently oversubscribed, so Ministers will face some difficult trade-offs over the course of the Budget process.

In addition to funding for DHBs, there are a number of other pressures in Vote Health that will need to be funded in Budget 2015. These include pre-commitments (e.g. in-between travel), manifesto commitments, and funding for health services contracted directly by the Ministry of Health. Our best estimate of these pressures is detailed in this report. The Ministry is planning to seek an additional \$170 million to cover these costs, bringing the total health allocation to \$470 million. On top of this, there are some major fiscal risks sitting in Vote Health stemming from with the wind-up of Health Benefits Limited [8][10]

Announcing a funding signal of \$300 million to DHBs now is likely to mean that it is not possible to achieve a \$400 million package for health in Budget 2015.

Against this background, Treasury's preferred option is a funding signal of \$250 million. Under this option, DHBs will need to achieve combined efficiencies of around \$191 million, compared to \$141 million in efficiencies if they receive a \$300 million funding increase.

There is no doubt that the financial pressures facing DHBs under either option are considerable, particularly in terms of upcoming wage negotiations. However, these pressures apply in other sectors (e.g. police and education), and ongoing fiscal restraint has been clearly signalled to the health sector.

Last year, DHBs received \$250 million and were told that they should assume a similar level of increase in out-years in their planning. The Ministry of Health's view is that a funding increase of \$250 million in 2015/16 will result in an increase in deficits. We see it as a core part of the Ministry's role to assist the sector to meet the Government's goals – including the fiscal strategy – but it appears to be reluctant to develop options which would create headroom elsewhere in the Vote and hence provide choices for Ministers. Such options should be included in the Ministry's Four-year Plan for the health sector, but we are not aware of any such choices being developed.

Making a judgement about the size of the funding signal for DHBs is difficult given the fact that Ministers do not have good information about pressures in other Votes this early in the Budget process. As such, we recommend that the DHB funding signal process be reviewed well ahead of Budget 2016 so that it can be better integrated into overall Budget advice.

Recommended Action

We recommend that you:

- a **note** that the Minister of Health is planning to seek Cabinet's agreement to a funding signal of \$300 million to District Health Boards for the 2015/16 year, with an announcement to be made prior to Christmas
- b **note** that in addition to funding for District Health Boards, there are a number of other pressures sitting in Vote Health that will need to be funded in Budget 2015, and that the Ministry of Health plans to seek \$170 million to cover these
- c **note** that there are also major fiscal risks sitting in Vote Health which may need to be funded in Budget 2015. stemming from the wind-up of Health Benefits Limited [8][10] but the scale of these costs is uncertain at this stage
- d **note** that the operating allowance for Budget 2015 is currently oversubscribed with a health allocation of \$400 million, and that increasing the size of the health allocation will put further pressure on other parts of the Budget
- e **agree** to a \$250 million funding signal for District Health Boards for 2015/16
Agree/disagree
- f **agree** that the timing of the District Health Board funding signal process be reviewed prior to Budget 2016 so that it can be integrated into wider Budget advice, and
Agree/disagree
- g **discuss** the contents of this report at Fiscal Issues on Tuesday 2 December.

Ben McBride
Manager, Health

Hon Bill English
Minister of Finance

Hon Steven Joyce
Associate Minister of Finance

Hon Paula Bennett
Associate Minister of Finance

Treasury Report: Advice on District Health Board Funding Signal for 2015/16

Purpose of report

1. A funding signal is usually given to District Health Boards (DHBs) in November or December to allow them to complete a first draft of their Annual Plans by March of the following year.
2. We understand the Minister of Health may be taking a late paper to SEC on 3 December seeking agreement to announce a \$300 million funding signal to DHBs for the 2015/16 year. The announcement of a funding signal to DHBs is an important decision as it essentially locks in a significant component of the operating allowance for the upcoming Budget.
3. This report sets out some of the wider context that you should consider before making a decision on how much should be allocated to DHBs.

Budget 2015 context

4. Prior to the finalisation of the Half-year Economic and Fiscal Update, Ministers have confirmed that the operating allowances for Budgets 2015 and 2016 will be around \$1 billion.
5. Allowances of this size will be very tight given known operating pressures, particularly wage settlements (in health, education and police) and the work on children in material deprivation. In addition to these pressures, there are a number of smaller initiatives that require new funding in Budget 2015. The Government's explicit commitment to returning to surplus and debt repayment reinforces the importance of managing within these allowances.
6. Cabinet has not yet determined the size of the health allocation for Budget 2015, but Treasury's current working assumption is an allocation of \$400 million (Vote Health received \$350 million in Budget 2014).
7. When considering all of these pressures together, the operating allowance for Budget 2015 is currently oversubscribed. As such, Ministers will need to make difficult decisions and tradeoffs over the course of the Budget process.

Pressures in Vote Health

8. Although funding for DHBs will make up the majority of funding for health in the Budget, the allocation also needs to cover a range of other pressures. The Ministry of Health is planning to seek an additional \$170 million to cover these on top of the \$300 million for DHBs.
9. Table 1 sets out what we know about these pressures at this point in time. Note that a number of these items are currently under discussion between the Minister of Health and his officials and are likely to change, but we have included them here to give you a sense of the scale of overall pressures in Vote Health.

Pressures on District Health Boards

11. DHBs face pressures from demographic changes (more people, ageing population, etc.) and cost growth (wages and prices). DHBs managed with \$250 million of new funding last year through a combination of savings, pay restraint, and additional revenue for ACC and electives.
12. The Ministry of Health has identified four main challenges facing DHBs in 2015/16, which it considers will make it more difficult for them to manage within a \$250 million funding envelope:
 - specific wage pressures (e.g. the nurses' collective agreement is up for renegotiation and settlement next year)
 - uncertainty around continued revenue growth from ACC and electives
 - reduced scope for savings through PHARMAC and HBL
 - adjustments to demographic projections ('re-basing'), which mean that the distribution of funding across DHBs needs to be rebalanced, creating transitional issues.
13. Treasury officials have modelled demographic and non-demographic cost pressures for individual DHBs. The modelling takes 2014/15 funding levels as its starting point and assumes that DHB cost structures are essentially fixed. The analysis therefore has nothing to say about the capacity of individual DHBs to absorb pressures through reallocation of resources and efficiencies. Our approach is similar to that used by the Ministry in its population-based funding formula.
14. Table 2 provides a breakdown of cost pressures for each DHB. We estimate that total pressures facing DHBs are [12] We calculate cost pressures on a top-down basis using demographic data and assumptions about wage and price inflation.¹
15. As noted above, the analysis is complicated this year by the 're-basing' of population projections by Statistics New Zealand to reflect the 2013 Census and updated net migration data. Another rebasing exercise is not expected until after the next Census. The new projections better reflect the distribution of the New Zealand population between DHBs, but create transitional funding issues. Some DHBs have larger populations than those for which they are currently funded. Others have smaller populations. A rebalancing of funding across DHBs is therefore required. This is shown separately in table 2 as a 'rebase adjustment'. In practice, this adjustment will be phased in over a number of years (we return to this point later).

¹ We have used DHB-level data to determine the breakdown between provider-arm and contracted services. We have also used DHB-level data to calculate the split between wage and non-wage costs for provider arm-services (a 65/35 split is about average). For contracted services, we have assumed a fixed (70/30) split between wage and non-wage costs across all DHBs.

Table 2: Demographic and non-demographic cost pressures (\$m)

	2014/15 baseline funding	Pressures					Total
		Demo- graphic	[12]	Inflation (1.59%)	Current (ex re-base)	Re-base adjustment	
Auckland	1,074	21		6	[12]	14	[12]
Bay of Plenty	615	14		3		1	
Canterbury	1,258	31		7		(27)	
Capital and Coast	678	12		4		(12)	
Counties Manukau	1,246	31		6		(28)	
Hawke's Bay	435	8		2		9	
Hutt	357	5		2		(8)	
Lakes	278	4		2		2	
Midcentral	458	6		3		(2)	
Nelson Marlborough	378	10		2		4	
Northland	488	11		3		21	
South Canterbury	164	3		1		(1)	
Southern	775	12		4		(4)	
Tairāwhiti	144	2		1		2	
Taranaki	304	7		2		8	
Waikato	995	23		6		21	
Wairarapa	122	3		1		2	
Waitemata	1,309	41		7		(19)	
West Coast	119	2		1		(3)	
Whanganui	202	2		1		(2)	
Total	11,401	249		62		(20)	

Options

16. There are two broad options for Ministers at this stage to manage within a \$400 million allocation for Vote Health:

Table 3: Options for the DHB funding signal

Option	Total allocation	DHB	Other	Discussion
A	\$400m	\$250m	\$150m	<p>This option would require DHBs to make reprioritisation and efficiency savings of an estimated \$191 million (1.7 percent), while providing a \$150 million allowance for other pressures and risks. [9]</p> <p>Our view is that these pressures are not unique to the health sector, and that given the limited funding available in Budget 2015, funding DHBs at a higher level will result in increased pressures on other sectors. DHBs received \$250 million last year and were told to assume a similar dollar level of increase in the following two years.</p>
B	\$400m	\$300m	\$100m	<p>This option would require DHBs to make reprioritisation and efficiency savings of \$141 million (1.2 percent), but makes less allowance for other pressures and risks in Vote Health. Manifesto commitments would need to be scaled back and phased in more slowly over time, and the Ministry would need to find further savings in its contracted services. It does not make an allowance for the management of other risks such as HBL transition costs and [8][10] [12]</p>

17. A third option would be to give Vote Health more funding in Budget 2015, which is the Ministry of Health's preferred way forward (i.e. a \$470 million allocation). Given the fact that the operating allowance is already oversubscribed with an allocation of \$400 million, the Treasury has concerns about the affordability of this option, which would shift pressure to other areas of government (e.g. education or police wages) and/or reduce the amount available to fund the children in material deprivation work.
18. As such, Treasury's preferred option is a funding signal of \$250 million for DHBs (option A). There is no doubt that the financial pressures facing DHBs are considerable, particularly in terms of upcoming wage negotiations. However, these pressures apply in other sectors (e.g. police and education), and ongoing fiscal restraint has been clearly signalled to the health sector. Last year, DHBs received \$250 million and were told that they should assume a similar level of increase in out-years in their planning.
19. [9]
 We see it as a core part of the Ministry's role to assist the sector to meet the Government's goals – including the fiscal strategy – but it appears to be reluctant to develop options which would create headroom elsewhere in the Vote and hence provide choices for Ministers. Such options should be included in the Ministry's Four-year Plan for the health sector, but we are not aware of any such choices being developed.
20. Making a judgement about the size of the funding signal for DHBs is difficult given the fact that Ministers do not have good information about pressures in other Votes this early in the Budget process. As such, we recommend that the DHB funding signal process be reviewed well ahead of Budget 2016 to provide options for integrating the process into wider Budget advice.

Distribution of funding across District Health Boards and implied efficiencies

21. Table 4 summarises the composition of the two funding options at an aggregate level.

Table 4: Composition of funding options

	\$300m package		\$250m package	
	\$m increase	% increase	\$m increase	% increase
Increase due to demographic pressures	234	2.06	234	2.06
Raw population	159	1.4	159	1.4
Ageing population	75	0.66	75	0.66
Contribution to cost pressures	66	0.57	16	0.14
Total increase in DHB funding	300	2.63	250	2.19

22. Table 5 shows the distribution of funding and implied efficiencies under each of these packages. Under each package, allocations to DHBs include a full contribution to annual demographic pressures, a partial contribution towards non-demographic cost pressures (0.57 percent and 0.16 percent for the \$300 million and \$250 million packages respectively), and an adjustment to facilitate a transition to the new funding levels implied by the re-based population projections.
23. Efficiency requirements are shown as a percentage of 2014/15 funding and are broken down in terms of:

- current pressures (excluding the re-basing exercise). This shows the extent to which each DHB will need to find efficiencies given its *existing* cost structure and annual movements in demographic and non-demographic cost drivers.
- total pressures (which includes re-basing). This shows the extent to which each DHB will need to find efficiencies once updated population projections are taken into account, given that funding adjustments to reflect re-basing will be phased in over time.

Table 5: Distribution of funding and implied efficiencies

	Pressures		\$300m Signal			\$250m Funding Signal		
	Current	Total	New funding	Implied efficiency*		New funding	Implied efficiency*	
				Current	Total		Current	Total
Auckland	[12]		39	[12]		35	[12]	
Bay of Plenty			20			18		
Canterbury			19			13		
Capital and Coast			10			7		
Counties Manukau			19			13		
Hawke's Bay			18			16		
Hutt			5			4		
Lakes			6			5		
Midcentral			7			5		
Nelson Marlborough			16			15		
Northland			22			19		
South Canterbury			3			2		
Southern			14			11		
Tairāwhiti			3			2		
Taranaki			14			12		
Waikato			44			39		
Wairarapa			5			5		
Waitemata			33			28		
West Coast			2			1		
Whanganui			3			2		
Total			300			250		

* A negative number indicates an implied efficiency. A positive number indicates that new funding exceeds modelled cost pressures.

24. The DHBs facing the most significant current pressures are [9] These DHBs are most likely to face short-term difficulties adjusting to the year-on-year pressures they face. The transition to re-based funding levels reduces the amount of new money they receive in 2015/16 relative to annual demographic and price movements. This increases the short-term risk of DHBs moving into a deficit position. The effect will persist for a number of years, as re-based funding levels are phased in gradually.
25. The DHBs facing the most significant total pressures are [9] These are the DHBs for which the 2015/16 funding signal will be furthest below the level implied by the size and characteristics of their (re-based) population. [9] At the same time, the re-basing exercise means that these DHBs face smaller short-term structural adjustments than they would otherwise by increasing the amount of new money they receive relative to year-on-year pressures. A number of other DHBs also benefit from this effect in 2015/16, [9]

Minimum and maximum funding

26. Each year, the Ministry sets a minimum and a maximum amount of new funding that any DHB can receive, regardless of its 'correct' allocation under the population-based funding formula. This smoothes out funding adjustments and ensures that all DHBs get a funding increase sufficient to address wage and other non-demographic cost pressures.
27. For the \$300 million funding package, the proposal is for a 1.5 percent minimum increase and a 4.5 percent maximum. For the \$250 million package, a 1 percent minimum and a 4 percent maximum is proposed. These limits are reflected in table 5 and lead to the variation in efficiency requirements across DHBs. Under either funding package: Northland, Taranaki, Waikato and Wairarapa are at the maximum; and Canterbury, Capital and Coast, Counties Manukau, Hutt, MidCentral, West Coast and Whanganui are at the minimum.
28. The significance of the minimum and maximum amounts is greater when (as now) funding is tight and the population projections are re-based. DHBs with lower rates of population growth face less pressure to find efficiencies than rapidly growing DHBs.
29. There is a question about whether the policy of providing a minimum increase to slow-growing DHBs is sustainable over the medium-term, given on-going fiscal constraints. Providing DHBs with a minimum increase puts them above their population-based funding share in the current year. The extra funding would normally be netted off against future increases. However, funding restraint in recent years means this has not been possible for DHBs with low rates of population growth (West Coast and Whanganui). This is one issue that will need to be considered as part of the current review of the population-based funding formula.

Inter-district flows

30. Inter-district flows cover funding transfers when one DHB provides a service to a person for whom a different DHB receives capitated (population-based) funding. The price schedule used for inter-district flows has increased faster than funding levels, reflecting the fact that costs have risen by more than the contribution to cost pressures under the population-based funding formula. This benefits DHBs that are net providers of inter-district services, and disadvantages DHBs that are net purchasers of such services. The greatest beneficiary of this is Auckland, which will receive approximately \$9 million in extra payments. The largest cost (\$5 million) is borne by Waitemata.

Top-sliced funding arrangements

31. The majority of DHB funding is allocated on the basis of the population-based funding formula. However, some DHB-provided services are funded on a cost basis, with the money being top-sliced from DHB allocations. This is generally done for services and costs which do not fit the population-based funding model or for new initiatives in the initial few years of set-up.