

Treasury Report: Budget 2008: Bilateral for Vote Health

Date:	29 February 2008	Report No:	T2008/301
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Dr Michael Cullen)	Read before the Bilateral with Hon David Cunliffe	Before 7.00pm on Wednesday 5 th March 2008.
	Refer a copy to Hon David Cunliffe	Monday 3 rd March 2008.
Associate Minister of Finance (Hon Trevor Mallard)	Read before the Bilateral with Hon David Cunliffe	Before 7.00pm on Wednesday 5 th March 2008.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact	
Claire Douglas	Manager, Health	[deleted – privacy]	[deleted – privacy]	✓
<i>[information deleted in order to protect the privacy of natural persons, including deceased people]</i>				

Minister of Finance's Office Actions

Refer a copy of this report to Hon David Cunliffe by Monday 3rd March 2008.

Enclosure: No

Treasury Report: Bilateral Briefing for Vote Health

Attached is a briefing for the bilateral between the Minister of Finance and the Minister of Health at 7.00 p.m. on 5 March 2008 to discuss the budget package for Vote Health.

The bilateral briefing is structured as follows:

Recommendations	p. 3
Analysis of Vote Health	p. 6
Appendices	p. 14

We expect the key issues for discussion will be:

- the Health capital allocation and future capital pressures
- the availability of funds to supplement a central capital allocation
- strategies for managing key sector risks and impacts on the proposed operating package.

Treasury's view is that a \$50 million capital contribution is appropriate to meet the most pressing capital needs if supplemented by anticipated operating underspends.

The Ministry of Health's view is that a capital allocation of between \$74.5 and \$163 million will be required to meet identified pressures.

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

Recommended Action

We recommend that you

- a **read** the attached briefing and use it as the basis for making decisions in your bilateral with the Minister of Health at 7.00 p.m. on 5 March 2008; and
- b **refer** a copy of this report to the Minister of Health.

Yes/No

Claire Douglas
for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

Recommendations

VOTE HEALTH

a Budget 2008 Health Capital Allocation

analysis p. 6

- *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*
- The Ministry proposes a Health capital allocation from the Crown of between \$74.5 and \$163 million. This range allows for existing funds in the envelope (\$114 million) and *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*.
- Treasury's view is a capital allocation of \$50 million is appropriate given wider government capital priorities and the current uncertainties about Health capital pressures. When combined with existing funding in the Health capital envelope, this would provide \$164 million for capital pressures. This amount could be augmented by operating to capital swaps. Further information on key sector risks *[deleted – confidentiality of advice]* and the analysis of identified capital pressures will help determine the relative value of the trade-offs between capital and operating priorities. Minimal underspend transfers (in the order of \$88.5 million) would provide a reasonable capital allocation without compromising risk provisioning.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 Only</i>
<i>Capital (GST excl)</i>					
Ministry of Health	-	\$74.5 - \$163 million			
Treasury	-	-	-	-	50.000

- i **Invite** the Minister of Health to identify potential one-off funding from operating sources to be transferred to capital to augment available funding to manage capital pressures, such that these do not compromise the appropriate levels of risk provisioning.

Yes/No

b Health Operating Package

analysis p. 9

- Total Operating Package and Further Pressures*
- **Note** the proposed Vote Health Budget 2008 operating package in Appendix 2 exceeds the allocation of \$750 million by \$36 million per annum in outyears.
 - **Note** that the proposed operating package includes a \$50 million per annum risk reserve *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
 - *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
 - **Note** that first indications of DHB deficits will be provided by Boards in their

<p>District Annual Plans which are due on 7 March 2008.</p> <ul style="list-style-type: none"> • Note that information on the intended strategies for dealing with key risks and pressures [<i>deleted – confidentiality of advice</i>] will be needed to inform decisions about the appropriate size of risk reserves, the adequacy of DHB deficit support provisions, and the most prudent use of underspends. • Note that a re-examination of the operating package could provide options to either minimise precommitments or to free up funding to manage further pressures. For example, Ministers could defer the lowest priority initiatives, where policy work is underdeveloped, or where reviews are pending.
<p><i>Agreement of the Health Operating package</i></p> <ul style="list-style-type: none"> • Note that the Vote Health Budget 2008 package will be considered alongside the FYO budget package by Senior Ministers on 18 March 2008.
<p><i>Indicative Outyear Allocations</i></p> <ul style="list-style-type: none"> • Note that Treasury officials will prepare advice on criteria for setting indicative operating allocations after the Budget at the next quarterly bilateral.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>
Budget 2008 allocation	-	750.000	750.000	750.000	750.000
Contribution from Vote Health Baselines	6.000	36.500	35.227	34.382	34.382
Contribution from Crown contingency for Health	11.129	30.444	41.700	11.000	-
ACC PHAS revenue	-	29.500	29.500	29.500	29.500
Rephasing of revenue	(68.444)	50.228	18.091	0.125	-
Total available for new initiatives in Budget 2008	20.846	896.672	874.518	825.007	813.882
Precommitments	-	28.337	40.905	49.132	50.517
Strategic Initiatives	10.129	744.386	733.667	686.914	675.914
Primary Healthcare	-	43.996	45.452	47.223	53.271
Sector capability and Governance	7.000	49.159	55.730	59.937	70.612
Surplus/(Precommitment) required	3.717	30.794	(1.236)	(18.199)	(36.432)

- ii **Invite** the Minister of Health to finalise his operating package in light of his strategies to manage sector pressures for consideration at the Senior Ministers meeting of 18th March.

Yes/No

c Progress on Reviews Commissioned by Joint Ministers

analysis p. 12

- **Note** that work is underway on the following reviews commissioned by Joint Ministers to improve value for money and transparency in Vote Health.

iii **Direct** officials to report to Joint Ministers on progress for the next quarterly Bilateral (possibly in May) and with outcomes to inform Budget 2009 according to the following:

Yes/No

Review	Report to Ministers
<i>[deleted – confidentiality of advice]</i>	<i>[deleted – confidentiality of advice]</i>
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Vote Health – Analysis

Budget 2008 Health Capital Allocation (recommendation a)

1. This year's capital package represents a sizeable backlog of pressure in the Health capital budget. This has been the result of several factors: deferral of DHB capital investment over a number of years; the impact of legislative change to the Building Act; and population growth demand pressures.
2. DHBs have been required to complete comprehensive Health Services Plans, Site Master Plans and Asset Management Plans to ensure high quality business cases. Much capital investment has been deferred while this has occurred. A number of DHBs have now completed this process and are putting forward proposals to replace obsolete assets. It is expected that similar business cases will continue to be developed going forward.
3. Changes to the Building Act have resulted in several existing hospital buildings being classified as non-compliant earthquake-prone buildings. This prevents hospitals from being upgraded or refurbished as to do so would result in DHBs being non-compliant with the legislation, requiring either a seismic strengthening programme or demolition and new build *[deleted – confidentiality of advice]*.
4. Population growth, particularly in the Auckland region, will require a capital response to demand pressures. This demand is forecast to be present in three to five years time. However, the lead time to have the necessary infrastructure in place requires investment decisions to begin now e.g. *[deleted – confidentiality of advice]*.
5. *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*
6. The NCC process will largely respond to the size of the allocation. It is important the allocation is sufficient to manage all critical pressures, but the size of the allocation also serves to set sector expectations about capital investment from the centre. Ensuring the medium to long term sustainability of Crown capital investment requires that decisions on the size of the capital envelope balance known pressures on the horizon, against the need to manage DHB expectations and encourage sustainable asset management planning by DHBs.
7. There is currently limited information on any of the identified pressures. Detailed assessment has not yet taken place. This lack of information is primarily due to a misalignment of the NCC processes for business case consideration and Budget timeframes. Both Treasury and the Ministry of Health agree that the NCC process needs to be realigned to meet Ministerial needs around informed budget decisions.
8. As a consequence it is difficult to confirm the accuracy of the indicated capital requirements or assess the relative priority of Health pressures against more developed calls against the Crown's capital allocation from other sectors. However, Treasury recognises that a further roll-out of the Health capital envelope is necessary to meet likely sector pressures, even though full details of these are not yet available.

9. There is currently \$114 million in the Health capital envelope to meet capital pressures. \$87 million was unallocated or indicatively tagged to Ministry of Health projects that do not need to be progressed in 2008/09 and are still subject to Ministerial approval.

Available Funds in the Health Capital Envelope	\$ million
Funds currently held within the health capital envelope for Ministry-led projects	87.000
Annual transfer of funds from DHB Deficit Support to the Health capital envelope	27.000
Total	114.000

Funding Sources

10. The capital available in the Health capital envelope could be further augmented from the central capital allocation or other funding sources from Vote Health which include:
- Unallocated funding in the proposed Budget 2008 operating package
 - Forecast year-end 2007/08 operating underspends
 - Reconsidering capital funding indicatively allocated *[deleted – confidentiality of advice]*
 - Freeing-up funding from within the operating package

Sources of possible capital funding	\$ million
Unallocated funding in the proposed Budget 2008 operating package	34.500
Forecast year-end 2007/08 operating underspends	54.000-120.000
Reconsidering capital funding	103.000
Freeing-up funding from within the operating package	Up to 260.000
Total	Up to 517.000

11. All of these options involve tradeoffs that need to be considered. These are discussed in detail below:
- Unallocated funding in the proposed Budget 2008 operating package

There is \$34.5 million of unallocated funding in the operating package. This is the result of moving forward anticipated underspent risk reserves from 2007/08. At the moment this funding is not assigned to any specific purposes. Therefore, the uses of these funds should be considered in the same light as underspends which are discussed below.

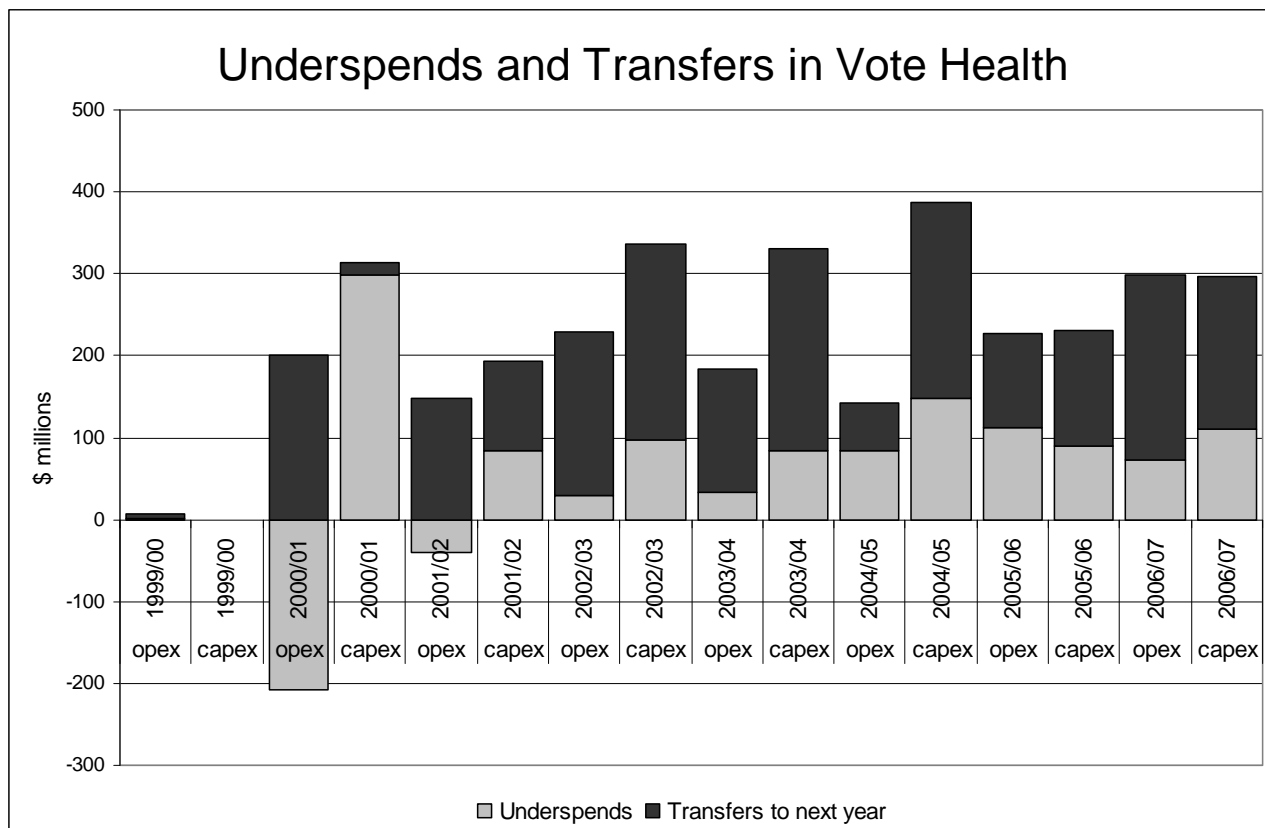
- Forecast year end 2007/08 operating underspends - \$54 to \$120 million (plus \$34.5 million of unallocated funding in the operating package)

Vote Health has a history of underspends which have been used to help manage capital pressures and sector risks requiring one-off funding.

Nature of the Underspends

The current Vote Health arrangements include the holding of risk reserves in the Vote (\$45 million in Budget 2007). Prudent management of risks will naturally produce underspends from this source. Underspends also arise from project delays from under-developed policy proposals or unforeseeable delays, and inaccurate expenditure forecasts. Capital underspends have largely resulted from front-loaded forecast expenditure profiles and

unforeseeable delays to projects. The Ministry of Health is working to improve expenditure forecasts for both operating and capital programmes to reduce the high levels of underspends which are common in Vote Health.



Large underspends in previous years have been the result of accumulated underspends transferred forward from previous years. These have now been applied to specific projects or capital so accumulated resources have been depleted. Only new underspends are available to be used for specific purposes.

Quantity

The Ministry of Health is currently estimating between \$54 million and \$120 million of operating underspends in 2007/08 plus \$34.5 million of effective underspends held as unallocated funding in the operating package. This includes underspends from risk reserves, DHB deficit support, and Ministry controlled non-departmental output expenses.

Uncertainty

Reliance on underspends to augment the capital allocation may mean that there is a level of uncertainty about the final size of the capital allocation until year end actuals are available. This uncertainty could limit the ability of the NCC to provide firm advice on which projects to progress to business cases at the April meeting. However, current forecasts indicate there is a high probability that there will be a minimum of \$88.5 million (\$54 million of underspends plus \$34.5 million of unallocated funds) available. Treasury and the Ministry agree that there is low risk associated with relying on these funds. At this point of the year, the Ministry of Health should be able to forecast underspends with reasonable accuracy to give sufficient guidance to the NCC.

Tradeoffs

The one-off nature of underspends limits the uses to which they can be put. Underspends can usefully be applied to capital projects, however, this precludes their use for operating

purposes such as DHB deficit support. Underspends cannot usefully be used to fund pressures such as industrial relations settlements with ongoing operating costs.

Officials consider that between zero and \$88.5 million could prudently be made available at this stage to support capital requirements. This range will be further refined as more information about underspends, capital priorities and operating pressures becomes available. Treasury notes that higher transfers from underspends could be made but this will likely require careful consideration of other key pressures.

- c. Reconsider capital funding indicatively allocated to *[deleted – confidentiality of advice]* – \$130 million

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

- d. Free-up funding within the operating package – up to \$260 million

The proposed operating package currently exceeds the indicative allocation by \$36 million in outyears. Ministers could choose to balance the package to outyears by removing the lowest priority initiatives to free more than \$100 million. The package also contains \$162 million of one-off funding; a portion of this could be transferred to meet capital pressures faced by the sector.

These options would require Ministers to trade-off between operating and capital pressures. The option of balancing the package to outyears is preferable as this will not compromise the prioritisation of initiatives. The Ministry of Health does not support these options given significant whole-of-government benefits associated with some of these initiatives and the additional pressure this could place on the risk reserves.

Recommended Options for the Health Budget 2008 capital allocation

12. The Ministry of Health's preferred option is to appropriate between \$74.5 and \$163 million in Budget 2008. This range would enable the critical pressures, identified *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*, to be managed without deferring key pressures and creating a future backlog.
13. Treasury's view is a capital allocation of \$50 million is appropriate given wider government capital priorities and the current uncertainties about Health capital pressures. When combined with existing funding in the Health capital envelope, this would provide \$164 million for capital pressures. This amount could be augmented by operating to capital swaps. Further information on key sector risks *[deleted – confidentiality of advice]* and the analysis of identified capital pressures will help determine the relative value of capital and operating opportunities and inform Ministers' decisions. Minimal underspend transfers (in the order of \$88.5 million) would provide a reasonable capital allocation without compromising risk provisioning.

Health Operating Package (recommendation b)

14. The Minister of Health has agreed to support the proposed package of Budget 2008 initiatives in Appendix 2. The following table summarises the proposed sources of funding for Budget 2008 and proposed expenditure grouped into Strategic Initiatives, Primary Healthcare and Sector Capability and Governance.

Proposed Budget 2008 package	\$million - increase/(decrease)				
	2007/08	2008/09	2009/10	2010/11	2011/12 & Outyears
Budget 2008 allocation	-	750.000	750.000	750.000	750.000
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Surplus/(Precommitment) required	3.717	30.794	(1.236)	(18.199)	(36.432)

Total Operating Package and Further Pressures

15. The proposed Vote Health Budget 2008 operating package exceeds the Health Budget 2008 allocation by \$36 million in outyears and would require funding to be precommitted against the Health indicative allocation for Budget 2009. Precommitting against future Budgets reduces flexibility to address pressures in future Budgets.
16. A risk reserve of \$50 million has been set aside within the Vote Health operating allocation to manage Health sector risks. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].*
17. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

Draft District Annual Plans are due on 7 March 2008 and a more definitive picture will be able to be provided then.

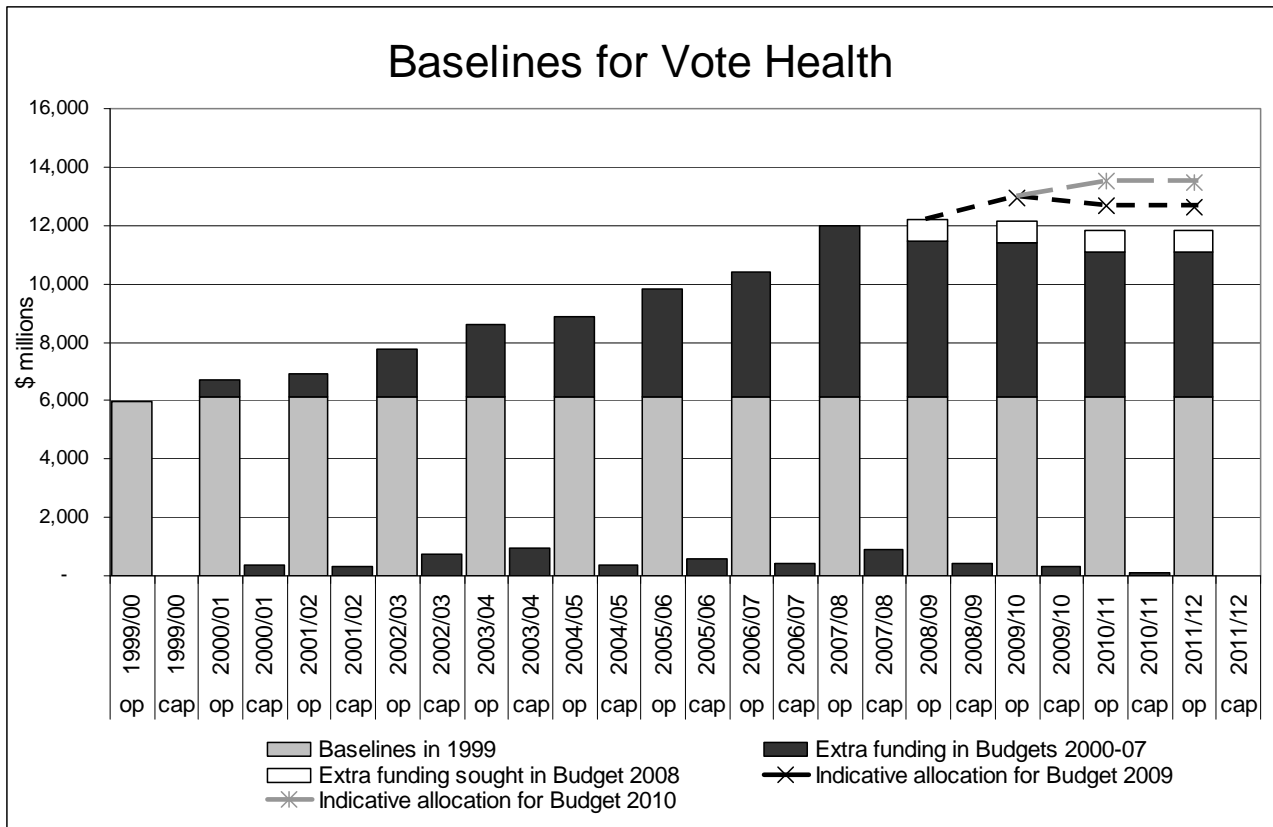
18. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
19. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
20. If Ministers wish to free up funding to minimise precommitments or to increase the size of the risk reserve, there are a number of alternative options to achieve this. Minister could:
 - a. choose to defer initiatives in areas with reviews underway or where the policy work is not completed such as
 - i. Primary Health Care Strategy Implementation Initiative (\$30 million). A strategic review of Primary Health Care Funding is currently underway and there is little information available on how this additional funding is to be used.
 - ii. Support for Health Sector to Build Capability and innovate (\$7 million). The policy work for this initiative has not yet been completed and there is the possibility to defer until Budget 2009; and/or
 - b. choose to defer lower priority initiatives for consideration in Budget 2009. The Ministry will provide advice on which items could be considered for deferral as the operating package is further refined.

Agreement of the Health Operating package

21. Senior Ministers will meet on 18 March 2008 to discuss and agree Theme Budget packages, including the Health operating package for Budget 2008. At this meeting Ministers will be able to consider the proposed Vote Health Budget 2008 package alongside the proposed FYO theme package, as discussed and agreed on 18 September 2007 with the previous Minister of Health. Consideration of the Health package should also include the Minister of Health's proposals to manage sector pressures and the appropriate levels of risk provisioning.

Analysis of Vote

22. Vote Health baselines are shown in the graph below. The vote has received significant funding increases since 1999 which has seen expenditure on Vote Health double.



23. Indicative allocations of \$800 million and \$850 million for Budgets 2009 and 2010 respectively were agreed by Joint Ministers during last budget to give funding security to DHBs and to allow for planning purposes. There is no requirement for Ministers to agree a further outyear indicative allocation in this Budget.
24. Officials propose to advise on criteria for setting indicative operating allocations for Vote Health after the Budget at the next quarterly Bilateral.

Progress on Reviews Commissioned by Joint Ministers (*recommendation c*)

25. On 18 September 2007, the Ministers of Health and Finance met to discuss Vote Health and Budget 2008. At this meeting Ministers commissioned a number of reviews to be carried out by officials' to improve value for money and transparency in Vote Health.

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

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

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Appendix 1 – Capital Pressures

The National Capital Committee (NCC) has an existing set of prioritisation criteria to be applied to strategic stage business cases in March and April each year. Because strategic stage business cases are currently due following the conclusion of the Crown budget process, not all the NCC criteria can be applied at this time. The following principles are extracted from the NCC strategic stage prioritisation criteria and adapted to enable their application to capital projects, where significant information is yet to be made available by DHBs.

Recommended capital prioritisation principles:

1. Legislative and safety requirements
2. Demand pressure and service quality
3. Value for money (for example securing return on existing committed investment, ability of the DHB to afford the project etc)
4. Asset condition and service efficiency (renewal of assets and development to enable more efficient service delivery)
5. Ability of DHBs to self fund components of proposed projects
6. Deferral is defensible

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

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

Appendix 2 - Proposed Vote Health Operating Package

The table below represents the current Vote Health 2008 operating package. Some alterations will be made to this package prior to it being submitted for Cabinet approval, notably, the Minister of Health has indicated a willingness to fund a number of FYO initiatives (the details of how this will be accommodated within the operating package are still being worked through). In addition, the outcome of your bilateral meeting with the Minister of Health may also lead to further changes.

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