

MEMORANDUM TO CABINET COMMITTEE ON EDUCATION AND HEALTH
FISCAL IMPLICATIONS OF THE HEALTH SECTOR STRUCTURAL CHANGES

PROPOSAL

1. The purpose of this paper is to :
 - (a) report back to Cabinet Committee on the fiscal implications of the health sector structural changes and
 - (b) to seek Cabinet agreement to the transfer of election costs within Vote Health.

EXECUTIVE SUMMARY

2. On 26 June 2000 Cabinet instructed officials to prepare a report back on the costs, savings and sources of any savings relating to health sector changes. This is the report back.
3. The fiscal impact of the health sector structural changes in 2000/01 is \$14.5 m. This has been met by the Health Sector Development appropriation of \$20.0 m. The balance of this appropriation, \$5.5 m, has been transferred to 2001/02.
4. The 2001/02 fiscal impact of \$17.5 m has been met in part by the transfer of \$5.5 m from the 2000/01 Health Sector Development appropriation. The remaining balance of \$12.0 m has been resolved through the 2001 budget process which allocated \$12.0 m as a contribution to the costs of sector change.
5. The fiscal impact in 2002/03 and 2003/04 is \$6.3 m and \$5.7 m respectively. This is to be funded through the 2001/02 budget allocation. \$12.0 m has been allocated in 2002/03 and a further \$12.0 m in 2003/04 as a contribution to the costs of sector change. This represents an upper limit to costs and any excess will be transferred for service funding. A minimum of \$5.7 m in 2002/03 and \$6.3 m in 2003/04 onwards will be allocated to service funding.
6. The ongoing cost of \$5.7 m per annum is thought to be ambitiously low by the Treasury. However, the Ministry of Health is confident that this provision is adequate. If it is exceeded the additional funding in this year's budget will be available. Should the allocation in this year's budget be exceeded the additional costs will be met by compensating efficiency and effectiveness savings.

7. The election costs are currently allocated to the Ministry of Health while agencies finalise the mechanisms associated with conducting elections. DHBs will be responsible for elections from 2002/03 onwards. It is proposed that Vote Health NDOCs : Health and Disability Support Services DHB Districts be increased by \$1.655 m in 2002/03 and outyears. It is proposed that Vote Health NDOC : Health Sector Development be decreased by \$1.655 m in 2002/03 and outyears.

BACKGROUND

8. On 31 January 2000 Cabinet directed officials to report back with full identification of the one-off costs and ongoing fiscal impacts of the proposed structural changes, key fiscal risks and mechanisms to manage them [CAB (00) M 2/4 refers]. Officials provided an assessment of likely costs of the health sector changes based on decisions made up until 12 May 2000 on 26 June 2000 [SPH (00) 85 refers]. Cabinet instructed (CAB (00) M 21/13 rec f) officials to report back by 31 December 2000, and subsequently if necessary, when all policy decisions have been taken and transitional plans have been received, on the costs, savings and sources of any savings relating to health sector changes. This is the report back.

COMMENT

9. The staffing resources required for DHBs were estimated based on equivalent functions within the Health Funding Authority (HFA). The results of this were factored into the costs of change. The Ministry of Health has since re-estimated its resource needs based upon its likely roles and the fixed costs that were transferred to it from the former HFA. In addition, negotiations with DHBs have also resulted in a small revision to costs.
10. The costs included in this paper are those costs which impact on Vote Health appropriations. There are additional costs being borne by the sector within current baselines (eg, DHB planning to date, Ministry of Health policy work), which are not included in these costs.
11. The fiscal impact arising from the health sector structural changes is outlined in Table 1. While the costs and savings are final, there are some outstanding issues to be resolved, including the level and treatment of interest savings arising from DHB financing restrictions. Any changes to the treatment of interest savings will need to be managed through the normal estimates process.

Table 1 : Fiscal Impact of the Health Sector Structural Changes

Gst incl	2000/01	2001/02	2002/03	2003/04
	\$M	\$M	\$M	\$M
Total Cost	114.7	119.0	113.7	113.7
Total Savings	100.2 ¹	101.5	107.4	108.0
Fiscal Impact (costs less savings) 20 April 2001	14.5	17.5	6.3	5.7
Appropriations	20.0	12.0	12.0	12.0
Previously advised Fiscal Impact 26 June 2000	12.0	0	0	0

12. The fiscal impact of \$14.5 m for 2000/01 is \$5.5 m less than the \$20.0 m Health Sector Development appropriation. Officials previously recommended that the \$5.5 m be transferred to 2001/02, leaving a shortfall of \$12.0 m in that year. This shortfall has recently been resolved following allocation of funds through the 2001 budget process. The 2002/03 net cost of \$6.3 m and 2003/04 net cost of \$5.7 m is to be funded through the 2001/02 budget allocation. \$12.0 m has been allocated in 2002/03 and a further \$12.0 m in 2003/04 as a contribution to the costs of sector change. This represents an upper limit to costs and any excess will be transferred for service funding. A minimum of \$5.7 m in 2002/03 and \$6.3 m in 2003/04 onwards will be allocated to service funding.
13. Table 1 compares the estimated fiscal impact with the fiscal impact advised to Cabinet on 26 June 2000. The variances are primarily due to:
- (a) the removal of an estimated \$22.5 m in procurement savings
 - (b) election costs conducted using first past the post constituency voting (FIN (00) M 32/3 refers)
 - (c) cost of new committees² required under the New Zealand Public Health and Disability Act (NZPHDA) 2000
 - (d) savings arising from DHB financing restrictions
 - (e) revised Board costs.
14. The savings identified in Table 1 comprise:
- (a) the former HFA appropriation. Functions previously performed by the HFA are currently undertaken by the Ministry of Health. As devolution of

¹ The savings relating to the former HFA comprise \$88.8 m for NDOC : Management of Health and Disability Funding. This relates to the full 2000/01 year. However, the former HFA was disestablished on 31 December 2000. For consistency purposes the full year operating period from 1 July 2000 to 30 June 2001 has been included in "total savings", when in fact the savings only apply for the six months following the HFA's disestablishment on 31 December 2000.

² Public Health Advisory Committee, National Advisory Committee on Health and Disability Services Ethics, National Health Epidemiology and Quality Assurance Advisory Committee, Pharmac's Consumer Advisory Committee.

the health sector structural changes progresses, these functions will be devolved out to DHBs

- (b) interest rate savings. The savings result from the decision that DHBs should source debt from the Crown only.

Table 2 : Breakdown of Sector Change Costs

Gst incl	2000/01	2001/02	2002/03	2003/04
	\$M	\$M	\$M	\$M
DHBs	11.3	38.1	56.6	56.6
Ministry of Health	97.0	74.5	50.7	50.7
Pharmac	6.4	6.4	6.4	6.4
Total Cost	114.7	119.0	113.7	113.7

15. The fiscal impact identified in Table 1 represents the additional net costs specific to the health sector structural changes. Savings from the former HFA and interest savings are offset to arrive at the fiscal impact or additional net cost. Table 2 highlights a breakdown of the sector change costs. The total cost comprises:
- (a) additional costs required to transform former HHSs into DHBs. These are operating costs only which include salaries, overheads, Board and committees, legal, auditing, monitoring, community consultation and Maori consultation costs
- (b) additional costs required to absorb functions undertaken by the former HFA into the Ministry of Health. This includes salaries of former HFA employees, overheads, Clinical Training Agency (CTA), Health Benefits (HB), ethics, additional committees as well as elections.
16. The election costs are currently allocated to the Ministry of Health while agencies finalise the mechanisms associated with conducting elections. DHBs will be responsible for elections from 2002/03 onwards. It is proposed that Vote Health NDOC : Health and Disability Support Services DHB Districts be increased by \$1.655 m in 2002/03 and outyears. It is proposed that Vote Health NDOC : Health Sector Development be decreased by \$1.655 m in 2002/03 and outyears.
17. Officials have developed a model, based on estimated resources required by DHBs, to fulfil their duties under the NZPHDA. Table 2 indicates that the total cost in 2000/01 is \$114.7m. Of this amount, the DHB component is \$11.3m. The DHB component rises to \$56.6 m in 2002/03, at which stage DHBs are expected to be fully functional³. Officials from the Ministry of Health have conducted extensive negotiations with DHBs to validate the level of DHB funding for the fully functional stage, and for the capability building phases.

³ This is dependent on the devolution of Disability Support Services, Public Health, and the administration of personal and mental health services. If the devolution of these functions from the Ministry of Health to DHBs is delayed or brought forward, the level of funding made available to DHBs will reflect this. The impact will be fiscally neutral as the funding will remain with the Ministry of Health.

18. Officials from the Ministry of Health have categorised DHBs according to their population size to determine their respective share of the funding. DHBs have also been grouped into four regional shared service agencies. The funding allocated to each DHB includes a contribution towards the operating costs of the shared services agency to which they have been assigned⁴. Table 3 summarises the estimated staffing needs of DHBs and shared service agencies when they reach their fully functional state in 2002/03 as per the model developed by officials.

Table 3 : DHB Resourcing Model

DHB Size	Population Range	Number	FTE's
Small	0 – 74,999	5	9.6
Medium	75,000 – 174,999	8	13.6
Medium Large	175,000 – 249,999	2	19.5
Large	250,000+	6	21.5
Shared Service Agencies	N/A	4	16.8

19. DHBs can depart from the costs outlined in the model. DHBs will choose their own level and mix of staff which will be agreed and managed through the accountability framework. The model is considered by the Ministry of Health to be realistic in order to meet the base functions and responsibilities of DHBs. Officials note that nine DHBs are able to manage within this allocation and that a further five DHBs are within \$0.1 m. A DHB may, for example, need to increase salary rates to employ specialist skills, or pursue specific strategies. DHBs will have the flexibility to prioritise and use savings from other areas of their overall funding package with the agreement of the Minister of Health. As with any model, there will be some mismatch between DHBs estimates of costs and the model. DHB choices relating to skill mix and remuneration are an internal management issue, which does not impact on the sector change costs. Without a model of costs, equity of allocation between DHBs would be reduced.
20. The key accountability document for each DHB from 1 January 2001 until 1 July 2001 is the Crown Funding Agreement. This agreement includes (amongst other things) the funding that the DHB will receive, the DHBs plans for building their capability to take on funding functions from 1 July 2001 and a set of clear performance indicators to measure their progress towards that goal.
21. As at 20 April 2001, Capital and Coast DHB and MidCentral DHB are the only DHBs that have not yet signed their Crown Funding Agreement for 2000/01 with the Minister of Health. Ten DHBs are able to operate within 2000/01 baselines. In some circumstances, a potential shortfall of funding has been acknowledged, on the condition the DHB will finance this over spend in a way that does not affect service delivery, and the DHB will recover the shortfall from future savings within a three-year period. The overall amount of shortfall for all DHBs, including DHBs who have yet to sign their Crown Funding Agreement is

⁴ The four shared service agencies are Health Share, Northern DHB Shared Support Agency Ltd, Central Technical Advisory Service and South Island Shared Support Agency Limited.

\$2.3 m⁵. This represents a \$2.3 m variance to the \$11.3 m 2000/01 cost outlined in Table 2. The level of shortfall for outyears is not yet available. Officials from the Ministry of Health are seeking to minimise the level of potential deficit approved for the DHBs expected to sign their Crown Funding Agreements shortly⁶.

22. As the devolution process progresses, DHBs will be given more flexibility in managing their operating budgets. DHBs may, for example, choose to expend more on improvements in monitoring. The fiscal impact arising from increased DHB flexibility will be managed through the annual planning processes.

CONSULTATION

23. Treasury is aware of the contents of this paper.

HUMAN RIGHTS ACT

24. There are no Human Rights Act implications.

FINANCIAL IMPLICATIONS

25. The financial implications arising from the health sector structural changes are \$14.5 m in 2000/01 and \$17.5 m in 2001/02. This has been funded through the Health Sector Development appropriation and the 2001 budget process.
26. The financial implications arising from the health sector structural changes are \$6.3 m in 2002/03 and \$5.7 m in 2003/04. This has been funded through the 2001/02 budget allocation. \$12.0 m has been allocated in 2002/03 and 2003/04 as a contribution to the costs of sector change. This represents an upper limit to costs and any excess will be transferred for service funding. A minimum of \$5.7 m in 2002/03 and \$6.3 m in 2003/04 onwards will be allocated to service funding.
27. Election costs require a fiscally neutral adjustment. It is proposed that Vote Health NDOC : Health and Disability Support Services DHB Districts be increased by \$1.655 m in 2002/03 and outyears. It is proposed that Vote Health NDOC : Health Sector Development be decreased by \$1.655 m in 2002/03 and outyears.

LEGISLATIVE IMPLICATIONS

28. There are no legislative implications.

REGULATORY IMPACT STATEMENT

29. A regulatory impact statement is not required for this paper.

⁵ \$0.9 m of this deficit relates to the Auckland and Counties-Manukau DHBs.

⁶ MidCentral, Hutt and Capital Coast DHBs have yet to sign their Crown Funding Agreements. Their combined deficit at this stage is \$0.9m.

PUBLICITY

30. I have made it a practice to release information on health sector changes as early as possible after key decisions have been made by Government. The health sector change costs will be released as part of the budget process.

ON 20 JUNE 2001 THE CABINET POLICY COMMITTEE, HAVING BEEN AUTHORISED BY CABINET WITH POWER TO ACT [CAB MIN (01) 19/3B]:

POL MIN (01) 15/3

FISCAL IMPLICATIONS OF THE HEALTH SECTOR STRUCTURAL CHANGES

Fiscal Implications

- 1 **noted** that the fiscal implications of the health sector structural changes are:

	\$m – increase/(decrease)				
	2000/01	2001/02	2002/03	2003/04	GST
Total Cost	114.700	119.000	113.700	113.700	Incl
Total Savings	100.200	101.500	107.400	108.000	Incl
Fiscal Impact (costs less savings) 20 April 2001	14.500	17.500	6.300	5.700	Incl

- 2 **noted** that the costs of the fiscal impact have been met within the health funding package;
- 3 **agreed** that if the fiscal impact exceeds the provisions made by the Government in the health funding package, this excess will be funded by efficiency and effectiveness savings within DHBs.