

# The Treasury

## Budget 2018 Information Release

### Release Document August 2018

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[40]	not in scope	
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## Treasury Report: Further Advice on the DHB Funding Signal and the PHARMAC Savings Proposal

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<b>Date:</b>	28 February 2018	<b>Report No:</b>	T2018/355
		<b>File Number:</b>	DH-1-2-3-2-4-2018

### Action Sought

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	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	<b>Note</b> recommendations	6 March 2018
Associate Minister of Finance (Hon Dr David Clark)	<b>Note</b> recommendations	6 March 2018

### Contact for Telephone Discussion (if required)

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Name	Position	Telephone		1st Contact
Bevan Searancke	Senior Analyst, Health	[39]	N/A (mob)	✓
Carolyn Palmer	Manager, Health	[39]	[23]	

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

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**Return** the signed report to Treasury.

Note any feedback on the quality of the report

**Enclosure:** No

## **Treasury Report: Further Advice on the DHB Funding Signal and the PHARMAC Savings Proposal**

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### **Executive Summary**

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This report provides you with further advice on the District Health Board (DHB) funding signal and the PHARMAC savings proposal as requested at the Budget bilateral meeting held on 15 February 2018. Separate advice on Dunedin Hospital will be provided in the context of work on capital allowances early next week.

Following the Budget bilateral meeting it was agreed that the Ministry of Health would provide advice to the Minister of Health on a number of other matters included in the Budget package for Vote Health. We will provide further advice to you once we have reviewed any revision to the Vote Health package.

#### *PHARMAC Savings Proposal*

The PHARMAC proposal, which has been submitted as a reprioritisation bid, is to:

- Add the remainder of hospital medicines to its Combined Pharmaceutical Budget (CPB).
- Return savings (\$188.7 million over four years) to Vote Health from a lower total CPB spend than the current combined funding trajectory for the CPB and DHB hospital medicines.

Since submitting its bid, PHARMAC has indicated it could provide additional savings of approximately \$22 million from the CPB in 2017/18 by starting the proposal earlier, in May 2018.

We support the proposal from Budget 18 on as it allows the redeployment of funds through the Budget process to the areas that will return the most benefits. [34]

[34]

## *DHB Funding Signal*

In previous advice (T2017/2698 refers) we have highlighted the problems with giving an early funding signal (ahead of final Budget decisions):

- It pre-commits the Government to a specific allocation outside the Budget process, and removes Ministers ability to trade-off and make choices in the context of wider Government priorities and the fiscal strategy.
- It creates an opportunity for DHBs to lobby through the planning process to increase funding - in Budgets 15 and 16 the final allocation through the Budget process was greater than the amount in the early funding signal.
- It risks encouraging agencies to operate outside the Budget process using pre-commitments, and also risks treating Vote Health as unique.

However, there is an opportunity to reset the DHB funding, planning and performance management approach and link it with the PHARMAC proposal discussed above which includes a pre-Budget announcement. In the following table, we have outlined a proposed process for Budget 18 which has been discussed with the Ministry of Health.

[34]

This new process could be announced by the Minister of Health in March (along with a move to implement a new planning and performance process).

Following Budget 18, we will work with the Ministry of Health on the funding and planning process for Budget 19 and future years.

In future years, further changes to improve the annual DHB planning process could be integrated with an enhanced Performance Framework which would provide a broader view on sector performance. [34]

## Recommended Action

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We recommend that you:

- a. **note** that there are a number of risks and implementation issues from progressing the PHARMAC savings proposal including the perception of reduced DHB funding for medicines
- b. **note** that in general, Treasury supports the PHARMAC proposal for Budget 18 and future years (with proposed savings of \$189 million over four years) as it allows reallocation to highest value interventions
- c. [34]
- d. **note** that Treasury will incorporate its assessment of the proposal into the proposed Budget 18 package.
- e. **note** Treasury will provide further advice on the treatment of savings in Budget 18 in the context of the broader work on reprioritisation
- f. **note** there is an opportunity to reset the DHB funding, planning and performance management approach and link it with the PHARMAC proposal, and
- g. **direct** Treasury and Ministry of Health officials to work together to implement the proposed DHB funding, planning and performance approach and the PHARMAC Budget 18 initiative, including Budget 18 announcements and future changes to improve the planning and performance process for 2019 and future years.

*Agree/disagree*  
Minister of Finance

*Agree/disagree*  
Associate Minister of Finance

Carolyn Palmer  
**Manager, Health**

Hon Grant Robertson  
**Minister of Finance**

Hon Dr David Clark  
**Associate Minister of Finance**

## Treasury Report: Further Advice on the DHB Funding Signal and the PHARMAC Savings Proposal

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### Purpose

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1. This report provides you with further advice on the PHARMAC savings proposal and the District Health Board (DHB) funding signal as requested at the Budget bilateral meeting held on 15 February 2018.

### PHARMAC proposal

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2. The PHARMAC proposal is to add the remainder of DHB hospital medicines (expenditure of approximately \$130 million per year) to its Combined Pharmaceutical Budget (CPB)<sup>1</sup> and return savings to Vote Health that can be reprioritised to other areas. The proposed savings are approximately \$189 million over four years, or \$211 million over five years if the proposal starts in the 2017/18 year (more details on this are provided below).
3. PHARMAC already manages savings and investment activities for hospital medicines. Adding the remainder of them to the CPB would reduce budget silos between hospital and community medicines, help targeting of investment to areas that will provide the most benefits to patients, and better support the tools PHARMAC can use to gain savings.
4. The proposal is consistent with PHARMAC's overall direction of travel to increase its support to DHBs by taking a greater role in the management of hospital medicines and hospital medical devices.
5. As part of the proposal, PHARMAC has requested the creation of an appropriation within Vote Health for the CPB from 2019/20 (this would be a change from the current approach where it manages expenditure on behalf of DHBs).
6. PHARMAC has advised that while an appropriation is their preferred approach, the proposal could go ahead without one. It could continue to manage funds on behalf of DHBs, and use a similar process to add the remaining DHB hospital medicines to the CPB to the one it used for adding cancer medicines in 2012.

### Analysis

7. The savings initially identified from the proposal are detailed in Table 1. Subsequent to the submission of its reprioritisation bid, PHARMAC has indicated that it can provide additional savings of approximately \$22 million in 2017/18 by starting the proposal two months earlier, in May 2018.

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<sup>1</sup> The CPB is an agreed expenditure level managed by PHARMAC on behalf of DHBs. Hospital cancer medicines are already included along with products including community dispensed medicines, vaccines, and haemophilia treatments.

**Table 1 Savings from PHARMAC proposal**

(\$ million)		2018/19	2019/20	2020/21	2021/22
	(A) Current CPB pathway	884.3	889.8	920.3	920.3
	(B) Hospital medicines transfer	130.0	130.0	130.0	130.0
	(C) Proposed CPB pathway	985.0	985.0	985.0	985.0
	(D) Counterfactual spend (A+B)	1014.3	1019.8	1050.3	1050.3
DHB appropriations	(E) DHB savings (C-D)	-29.3	-34.8	-65.3	-65.3
National Contracted Services - Other appropriation	(F) Increased PHARMAC operating costs	1.5	1.5	1.5	1.5
Vote Health	(G) Total Savings (E - F)	-27.8	-33.3	-63.8	-63.8

8. At a high level, we support the proposed approach, which should yield greater benefits from increased centralisation of sector procurement activities. It would also increase transparency around PHARMAC's funding level and may reduce administrative complexity for PHARMAC and DHBs.
9. [34]
- The increase to the CPB in 2018/19 for hospital medicines is less than the sum of DHB's current hospital medicines spend and the CPB's current pathway (see the 'Proposed CPB pathway' and 'Counterfactual spend' rows).
  - There is no funding increase for new medicines over the period from 2019/20 to 2021/22. Note: new funding for medicines was provided in Budgets 16 and 17 (\$124 million over four years in Budget 16 and \$60 million over four years in Budget 17).
10. PHARMAC's analysis is that it can fund its available pipeline of good value for money new medicines while also returning the savings. It considers that the funding identified for reprioritisation is best returned to Vote Health as more cost effective options to utilise the funds may be available elsewhere in the sector. [34]
11. [34]

12. Other risks around this proposal are that:

- There may be the perception that this is a reduction in DHB funding.
- There may be some technical issues (e.g. implications of setting up a new appropriation, IT and/or accounting issues) with implementing the proposal. PHARMAC has experience in taking on new medicines, for example, it has already organised adding hospital cancer medicines to the CPB. However, there is currently no separate appropriation in Vote Health for PHARMAC.
- PHARMAC's forecasts rely on expected savings in medicine and other product prices. If they do not occur to the level expected, it may not be able to fund high value new medicines or may exceed the CPB. However, from a budget risk perspective, PHARMAC has a strong track record of managing within the CPB and has never exceeded agreed levels since it was formed in 1993.
- There are a number of policy and implementation issues to work through including:
  - The interaction with the DHBs' Population Based Funding Formula.
  - Any implications for inter-district flows.
  - [34]
  - Whether the appropriation should be structured to facilitate the future addition of other areas of DHB expenditure (medical devices in particular).
  - [34]

13. Given these risks and policy and implementation issues, we recommend a phased approach.

#### *Budget 18*

14. Due to the number of policy and implementation issues, we do not think it would be feasible to introduce the proposed appropriation as part of Budget 18. However, while the risks and policy questions are worked through, it is still possible to recognise savings in Budget 18 over the forecast period.
15. In Budget 15, this was achieved by showing the DHB cost pressure initiative gross in the Estimates and having a separate line for PHARMAC savings. This reflects that DHBs will be paying less for hospital medicines in each year as a result of the savings generated by PHARMAC. Treasury is still working through how savings proposal will be treated and presented in Budget 18 documents and will provide further advice to Ministers in the context of the reprioritisation work across the state sector.
16. [34]

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[34]

## *Post Budget 18*

17. Following Ministerial consideration of further policy advice from the Ministry of Health on how to resolve the risks, policy and implementation issues outlined above, an appropriation could be established in Vote Health from 2019/20. The preferred timing is to do this as part of Budget 19 as it would need Cabinet approval and inclusion in the Appropriation (Estimates) Bills.
18. This would increase transparency and visibility over pharmaceutical spending and provide benefits from centralisation of sector procurement activities. It may also reduce administrative complexity for PHARMAC and DHBs.

## *Early savings in 2017/18*

19. PHARMAC considers that it can also generate approximately \$22 million in savings in 2017/18 while still funding its available pipeline of good value for money new medicines. There are two options for generating the savings:
  - Option 1 - PHARMAC makes a cash payment to DHBs funded by using CPB rebate cash it holds on behalf of DHBs.
  - Option 2 - The Minister of Health could approve a reduction in the 2017/18 CPB by the amount of the savings.
20. <sup>[34]</sup>

## *Funding for PHARMAC*

21. As noted in Table 1 above, PHARMAC has signalled a need for \$1.5 million per annum additional operating funding. <sup>[34]</sup>

We will engage

with the Ministry of Health around the level of PHARMAC's costs.

22. We recommend that the question of ongoing operating funding is deferred until the time when PHARMAC expands its medical devices operations which is also likely to require additional operating resources. <sup>[33]</sup>

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<sup>[33]</sup>

23. In December 2017, we provided joint advice with the Ministry of Health on District Health Board funding (report T2017/2698 refers). In that report we highlighted the problems with giving an early funding signal ahead of final Budget Cabinet decisions:
- It pre-commits the Government to a specific allocation outside the Budget process, removing Ministers' ability to trade-off and make choices in the context of wider Government priorities and the fiscal strategy.
  - It creates an opportunity for DHBs to lobby through the planning process to increase funding - in Budgets 15 and 16 the final allocation through the Budget process was greater than the amount in the early funding signal.
  - It risks encouraging agencies to operate outside the Budget process using pre-commitments, and also risks treating Vote Health as unique.
24. Treasury's advice is for Ministers to make a Budget pre-announcement in April 2018 once Cabinet has made Budget decisions. This would ensure consistent adherence to the Budget requirements and allow Ministers to make choices on the size and composition of Vote Health funding while considering broader Budget decisions and the fiscal strategy.

### *Proposal to improve the process*

25. Our recent advice on DHB Annual Plans (report T2018/293 refers) shows there are growing DHB deficits and a need for stronger fiscal and performance management. The annual planning process is compliance heavy and there is a lack of a longer-term system performance framework.
26. There is an opportunity to reset the DHB funding, planning and performance management approach, while also mitigating perceptions of a funding reduction from progressing the PHARMAC proposal.
27. The following table sets out at a high level how a revised process could work for Budget 18 with indicative timings. Following Budget 18, we will work with the Ministry of Health on the funding and planning process for Budget 19 and future years.
28. [34]

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<sup>4</sup> The Ministry can run modelling on a number of scenarios in advance of this date.

29. [34]

30. In future years, we consider that further changes to improve the annual DHB planning process could also be integrated with an enhanced Performance and Outcomes Framework which would provide a broader view on sector performance. [34]

## Preparation of the Estimates

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31. [34]

32. Improved quality assurance and review processes are part of the new proposed process outlined in Table 2 above.

## Other issues raised in the Budget bilateral

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### *Dunedin Hospital*

33. We understand that the main question regarding Dunedin Hospital related to possible phasing of capital allowances. Treasury is preparing separate advice for Ministers on this issue which will incorporate discussion on Dunedin Hospital. This will be sent to you early next week.

### *More specific remaining issues*

34. Following the Budget bilateral meeting it was agreed that the Ministry of Health would provide advice to the Minister of Health on a revised Budget package covering off the remaining issues raised for further consideration. We will provide further advice to you once we have reviewed the revised package.

## Consultation

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35. The Ministry of Health and PHARMAC have been consulted on this report.