

The Treasury

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Annex 1: Budget 22 Update - review of Health New Zealand's initial draft budget and implications for final Budget funding decisions

Purpose

1. This paper updates Ministers on the Ministry of Health and the Treasury's preliminary review of interim Health New Zealand's (HNZ's) initial draft budget (including Crown Monitors' views) with a focus on setting out implications for final Budget 2022 decisions ahead of Budget Ministers 6 on 1 April 2022. It seeks decisions from you to inform our drafting of financial recommendations for the Budget 2022 Cabinet Paper over the next week. Our advice in this paper is consistent with funding at the upper end of the communicated planning parameters and identifies options for managing known costs as well as residual risk.
2. There is considerable uncertainty about the non-discretionary costs of running the health system in the next two years, with potential for both upside and downside surprises. [33], [34]
[33] [34] . Given this, **we recommend to Ministers that**, rather than appropriating the full quantum of proposed cost pressure [33] and rebase [33] funding on Budget day, you instead initially announce a portion of the funding in a four-year operating contingency, for draw-down ahead of Day One and throughout 2022/23. This will signal your commitment to fully funding the new system, while also indicating your expectation that HNZ will take a strategic approach to allocation of funding across units, and pursue all available savings and efficiencies throughout the transitional period in order to see maximum investment in BAU activity line with reform objectives.
3. This paper also outlines next steps on the Ministry of Health's scrutiny process between final Budget decisions and Day One.

Assessment of Health NZ initial budget as at 24 March 2022

4. [33]
[33] [34] This upper end has been factored into the HNZ budget consolidation and initial draft, which was shared with the Ministry and the Treasury on 14 March 2022 and is still in the process of refinement. It will be presented to the HNZ Board on 25 March 2022, with further work to progress following this. We are having further conversations with Crown Monitors on Sunday 27 March 2022. A summary of HNZ's current budget is included at the end of this paper.
5. Based on the signalled increase in revenue and HNZ's understanding of Vote Health appropriations following the March Baseline Update, the initial draft budget [33]
[33] [34] The HNZ finance team has indicated potential savings of around [33] that may be possible to achieve at this level of funding, which could be used to manage the deficit.
6. HNZ has to date only been able to have one review session with each DHB on their submitted information. Significant further analysis is needed to refine this initial consolidation exercise as part of the HNZ planning process for 2022/23.

Material financial risks will remain.

7. [33], [34]

[38]

8. [38]

9. The budget consolidation work takes as its starting position the sector's planned budget for the 2021/22 financial year, rather than its year-to-date actual performance or current year-end forecasts. There is material in-year variation from plan due to both changes in BAU activity, as well as considerable COVID-19 funding and activity, with current forecasts for revenue and expenditure up \$1.3 billion and \$1.2 billion on plan respectively, with a small positive impact on the forecast net result. Given the difficulty of determining the BAU position in the current environment, HNZ's choice to work from the planned budget is reasonable; however, not taking the in-year variation into account creates risk in terms of assessing the right starting position for HNZ in 2022/23. While the Ministry remains of the view that [33] is a sensible amount for the rebase, there remains a risk that the deficit position will deteriorate over the remaining months of the financial year and exceed this amount.¹ The February DHB sector flash report (Annex 6) provides more detailed analysis.
10. There is also the risk of general inflationary pressure across all of health operating and capital costs. However, this applies across government more generally and is reflected in government-wide specific fiscal risks (SFRs).

There is opportunity for efficiencies and rationalisation over the first two years.

11. Agencies jointly requested the views of Crown Monitors on the initial budget position given their familiarity with and expertise on DHB financial planning. While highlighting the lack of information currently available, Crown Monitors considered that there is likely to be opportunities for savings and/or reprioritisation beyond the initial [33] identified by HNZ, requiring further exploration. Concerns raised to date include:

- [33], [34]

The Crown Monitors applauded the effort to consolidate DHB information and ensure 20 units are on the same system. They consider HNZ now needs to look to drive value in its budget and consider how the uplifts in revenue should be allocated across the system to support system sustainability, and to begin eliminating variation and supporting improved productivity. There will be limits about how much can happen ahead of Day 1 and so the design of HNZ's operating model and organisational structures and processes will be critical to ensure a strong performance management framework and function drives a systematic approach to identifying opportunities to reduce variation, increase efficiency and improve performance.

- [33], [34]

¹ The risk of deterioration will be recognised in a specific fiscal risk (SFR) for publication in the Budget Economic and Fiscal Update (BEFU) at Budget 2022.

[33]

[33]

- **Volume changes:** HNZ is not yet in a position to share the volume changes underpinning the initial draft budget for 2022/23 at the district level as it is still working through the information provided from DHB submissions. However, Crown Monitors consider it likely that DHB submissions will vary considerably and need to be tested at a national level. This work will happen through April 2022.

12. The Ministry and the Treasury also note that the draft HNZ budget builds in some extra costs relating to increased capital charge due to building revaluations. DHBs were not asked for any information on assumed revenue, and therefore it is unlikely that the initial draft budget factors in increased Crown revenue for the capital charge implications of revaluations or new capital assets coming on stream. Officials expect this could provide a further ~\$50 million in revenue to be funded from centrally held capital charge contingencies with no impact on the Crown's operating balance.

13. [33]

14. Stronger strategic analysis by HNZ of the baseline is required, including articulating the way in which additional revenue will support system transformation and performance improvement. The HNZ finance team has already indicated that further work is planned, but that it will take time. To ensure the right level of assurance can be achieved, this will rely on clear, early expectations on the future system from Ministers to the Board and senior management. These expectations will be reflected in the interim Government Policy Statement (iGPS) as well as in other key planning and accountability documents (interim New Zealand Health Plan (iNZHP), Statement of Performance Expectations).

Together these 'unders and overs' create significant uncertainty around what the revenue shortfall (if any) might be in 2022/23 and 2023/24.

Implications for Budget 2022 decisions

15. You have asked for further advice on the implications of funding Health cost pressures and rebase at the upper end of planning parameters, including remaining risk, to inform Budget Ministers 6 decisions on 1 April 2022.

16. Officials remain of the view that the health system will likely need the full \$1.8 billion as provided for at the upper end of the planning parameters, [33]

[34]

17. Given the significant uncertainty both upwards and downwards this early in the HNZ planning cycle, we are collectively keen to explore every option for savings, efficiencies and reprioritisation to get the best value out of the investment over the transitional period, and to gain more information on the materiality of the residual risk.

18. On 4 April 2022, the Ministry will submit fiscal forecasts to Treasury on behalf of HNZ and the Māori Health Authority (MHA). These forecasts will be based on HNZ and MHAs' draft budgets. We consider that, at the upper end of the planning parameters, and assuming [33], [38]

19. However, two key residual risks would remain, including that:

- [33]
- [38]

20. [34]

Acknowledging constrained Budget 22 allowances, Ministers have a number of options for how to manage this risk through final Budget decisions.

21. We outline three options for managing the risk via Budget 22 decisions, and their main benefits and disadvantages or risks, in the table overleaf. For all options, there will be SFRs and potential additional pre-commitments against Budget 23.

22. In assessing the options, we took into account the need to:

- a) send the right signals to HNZ both about Ministers' commitment to fully fund the system at the required level, and their desire for HNZ to design and implement a fiscal strategy that seeks efficiencies and performance improvements via changes to BAU;
- b) create the right mix of levers for Ministers and officials to support good quality planning and accountability documents for the first two years, via clear expectation-setting alongside support and scrutiny;
- c) communicate the selected option effectively, both to the public and HNZ; and
- d) implement the option in a way that supports high-trust engagement between all entities.

23. [33]

³ Note that this risk also exists for the MHA, but is less material.

<p>Option C (Recommended): Appropriate a proportion of the cost pressures [33] or rebase [33] in a four-year operating contingency in order to incentivise further scrutiny by HNZ, the Ministry and the Treasury over the next three months on costs and performance improvement opportunities. The contingency could be drawn down ahead of Day One and throughout 2022/23 as more analysis became available about choices and tradeoffs.</p>	<p>Sends a strong signal to HNZ about Ministers’ desire to properly fund non-discretionary and fixed health costs, while also highlighting Budget constraints, significant uncertainty about cost and delivery, and the need to seek value. Signals Ministers’ expectation that HNZ undertakes further work on its financial strategy to identify performance improvement opportunities and desirable changes to BAU activity.</p> <p>May help find further savings to reduce the risk that additional funding is required in 2022/23 and give us better information on what the remaining risk is for 2022/23.</p> <p>Will enable rephasing if that is found to be desirable to support fiscal sustainability, ie an “invest to save” approach.</p>	<p>Depending on conditions for access to contingency, could appear at odds with Minister’s commitment to fully fund the new system, and runs the risk of HNZ viewing this as a lack of trust.</p>	<p>Would need careful communication to emphasise Ministers’ continued commitment to fully fund the health system, and reiterate that the contingency is about buying time to resolve some of the uncertainty about how much funding is needed to do that.</p> <p>Would need to think about potential impact (in both logistical and signalling terms) of holding back cost pressures as opposed to holding back rebase.</p> <p>Would need to carefully manage the risks of frontloading spending in an “invest to save” approach.</p>
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24. [34]

If such a choice needs to be made, we think it is better to aim to make it closer to Day One on the basis of better information about HNZ’s budget and performance – especially as it may not need to be made at all.

Next steps

25. The Ministry is supportive of the work that HNZ is progressing and note the scale of the task to bring this work together. In recognition of the limited capacity that exists within HNZ at this point, the Ministry, the Treasury, and the Transition Unit anticipate working alongside HNZ to support them to progress strategic budget and planning related work.

26. Once the iNZHP is provided to agencies for analysis, we will be able to take more robust analysis of risk and opportunity across the HNZ budget and planned activity. As part of this work, we would anticipate providing HNZ with a list of follow-up questions and areas for further engagement including those noted above and including a requirement to undertake a systematic baseline or budget review as part of the next steps in its own budget process.
27. To support good fiscal and operational management, we anticipate working closely with HNZ and the MHA (to finalise their budget and planning intentions in advance of 1 July 2022, as set out in the table, below). The Ministry will brief you in April about how and where to best express specific planning expectations for HNZ and MHA to achieve collective clarity around what is needed and by when.

Review process	6 April	26 April	17 May (Budget day 19 May)	30 May	By 30 June
NZ health plan		First draft plan provided to the Ministry for review	Ministry feedback provided to entities	Board approved draft Health plan provided to the Ministry	Ministry advice prepared for Minister, and Ministerial response and approval of plan before 30 June
Budget information	Estimates – service performance and Budget loaded into CFIS-net	HNZ Budget and supporting information provided to Ministry for	Ministry feedback provided to entities	Draft final budget and complete analysis, including output of line-by-line review	Final budget incorporated into in Final plan/SOI and SPE
SPE and SOI (these will align to Estimates and iGPS)			Ministerial feedback on draft documents provided to entities (timeframe for feedback as per CE Act)		Board approved documents provided to the Minister SOI and SPE published on entity website

HNZ Initial Draft Budget figures as at 24 March 2022

[33]

