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TE TAI ŌHANGA THE TREASURY

MANATŪ HAUORA MINISTRY OF HEALTH

Joint Briefing

Multi-year funding for Vote Health: Coverage and design considerations

Date due to MO:	1/12/2022	**Action required by:**	07/12/2022
Security level:	IN CONFIDENCE	**Health Report number:**	H2022015438
		Treasury Report number:	T2022/2608
To:	Hon Grant Robertson, Minister of Finance Hon Andrew Little, Minister of Health		
Consulted:	Health New Zealand: ☒	Māori Health Authority: ☒	

Contact for telephone discussion

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Minister's office to complete:

☐ Approved	☐ Decline	☐ Noted
☐ Needs change	☐ Seen	☐ Overtaken by events
☐ See Minister's Notes	☐ Withdrawn	

Comment:

Multi-year funding for Vote Health: Coverage and design considerations

Security level:	IN CONFIDENCE	**Date:**	1 December 2022
To:	Hon Grant Robertson, Minister of Finance Hon Andrew Little, Minister of Health		

Purpose of report

1. This report covers the main design choices for the proposed multi-year funding arrangement for Vote Health. Specifically, it seeks your decisions on:
    a. the coverage and time horizon of the multi-year arrangement; and
    b. options for managing affordability and risk through the design of the arrangement.
2. This paper is presented alongside two accompanying briefings on multi-year funding for Vote Health:
    a. Multi-year funding for Vote Health: Budget 2024 work programme overview [H2022016892].
    b. Multi-year funding for Vote Health: Conditions for implementation at Budget 2024 [H2022015429].
3. This report discloses all relevant information and implications.

Summary

4. In October 2021, Cabinet agreed to the establishment of a multi-year funding arrangement for Vote Health from Budget 2024 subject to adequacy of accountability and governance settings, with the following features (SWC-21-MIN-0157 refers):
    a. a three-year funding commitment that covers all cost pressures and new investments in health over a three-year period; and
    b. a 'medium-term funding track' from year four to year six to support health sector planning and drive investment prioritisation decisions with impacts beyond the three-year funding commitment.
5. In Budget 2022, a two-year funding package was provided to set up the reformed system on a sustainable basis and provide funding certainty for the first two years. It provides time to develop a mature set of governance and accountability settings to underpin a full multi-year funding arrangement. Cost pressure funding in the Budget 22 package was informed by a model of health expenditure that was based on well-evidenced cost drivers of health spending and this model provides a starting point for work on the Budget 2024 health funding track.
6. Ahead of Budget 2024, there are several design choices that need to be finalised. In this paper, we seek your views on these decisions. Specifically:

a. Coverage of the multi-year funding arrangement (paragraphs **7-17**) – We recommend that the Budget 2024 multi-year funding arrangement cover all Vote Health including Ministry of Health funding. This would support better alignment across health spending but may affect the ability to make cross-Government trade-offs. This paper covers operational funding only; advice on Capital settings will be provided in July 2023 (SWC-Min-0063 refers).

b. The feasibility of developing a 'medium-term funding track' (paragraphs **18-19**) – Given health entities' multi-year planning and budgeting is still maturing, we recommend that the health funding model used to predict cost pressure funding for the system is focused on the three-year settlement only at this stage. We aim to provide further advice on the development of the medium-term funding track ahead of Budget 2024.

c. Ensuring the multi-year funding arrangement can respond to risk and affordability challenges (paragraphs **20-34**) – We recommend cost pressures are managed through an explicit risk buffer so that variations during the three-year period can be managed without requiring additional funding. Alongside this, a separate phased fund is recommended for funding Ministerial priorities during the three-year settlement period.

Recommendations

We recommend you:	Minister of Health	Minister of Finance
Coverage and time horizon for the multi-year funding arrangement		
a) **Agree** that for Budget 2024, subject to Ministers' confirmation, the multi-year funding arrangement will include all Vote Health funding, including: i. Service delivery costs covered by the New Zealand Health Plan (NZHP); and ii. Ministry of Health Departmental and non-Departmental operating funding, which will not be included in the NZHP.	**Yes/No**	**Yes/No**
b) **Note** that the Ministry of Health will develop a health funding model to provide a top-down estimate of the three-year costs for maintaining current policy settings.		
c) **Note** that for Budget 2024, this model will: i. focus on operating expenditure for Te Whatu Ora and Te Aka Whai Ora only, with cost pressures for other appropriations informed by separate analysis and Budget bids; and ii. cover the three years of the Budget 2024 settlement only (2024/25 to 2026/27), with further advice to be on the approach for developing an indicative 'medium-term funding track' ahead of Budget 2027.		
d) **Note** that Budget 2024 decision making on baseline health system costs will require that this model is complimented by bottom-up information from the NZHP.		

Managing risk and affordability

e)	**Agree** that the three-year funding commitment will include a buffer for variations in cost pressures so these can be managed during the settlement period without requiring additional funding.	**Yes/No**	**Yes/No**
f)	**Note** that in respect to recommendation (e), there are choices about whether all the cost pressure funding is held in entities baselines (with financial planning demonstrating how risk has been built into budgets) or separately as a tagged contingency at the centre.		
g)	**Note** that Joint Ministers will receive further advice on funding parameters for the Budget 2024 three-year commitment in February 2023, with the intention that Joint Ministers provide Budget 2024 planning parameters to Te Whatu Ora and Te Aka Whai Ora in March 2023 (following the March Budget 2024 progress check).		
h)	**Agree** that the three-year funding commitment includes a seperate phased contingency to fund new Ministerial priorities identified during the three-year settlement, to allow for any amendments or additions to the GPS.	**Yes/No**	**Yes/No**
i)	**Note** that if there was a genuinely extraordinary event or pressure that could not be managed within the existing settlement, Cabinet could consider re-opening the multi-year settlement.		
j)	**Note** in setting funding parameters for the development of the NZ Health Plan, Treasury's Budget templates and guidance will request information on specific funding scenarios that are less than the health funding track to show trade-offs of funding health below the track.		

Hon Grant Robertson
Minister of Finance
Date:

Hon Andrew Little
Minister of Health
Date:

Jess Hewat
Manager, Health
The Treasury
Date: 30/11/22

Dr Diana Sarfati
Director-General of Health
Manatū Hauora
Date: 30/11/22

Multi-year funding for Vote Health: Coverage and design considerations

Background

Cabinet has agreed to shift to a multi-year funding arrangement for health from Budget 2024, subject to conditions

1. In October 2021 Cabinet agreed to establish a multi-year funding arrangement for Vote Health from Budget 2024, subject to the adequacy of accountability and governance arrangements in the reformed system. This would comprise three-years of fixed funding to cover all cost pressures and new investments, and an indicative funding commitment from year four to six to support long-term sector planning and investment prioritisation (i.e., a 'medium term funding track'). Cabinet also agreed that the multi-year funding arrangement would include all Vote Health funding covered by the New Zealand Health Plan (NZHP), with an option to extend this to all of Vote Health including the Ministry of Health.
2. A multi-year funding arrangement will be a major evolutionary step for the health system, and its successful implementation at Budget 2024 will require:
    a. the effective transition from interim accountability arrangements into a mature framework that enables long-term planning and financial control; and
    b. the development of an aggregate funding model that is transparent and credible, projects the cost of maintaining health service coverage, and supports Ministers to make strategic choices around funding future health services
3. You have received joint Ministry of Health (the Ministry) and Treasury advice on a proposed set of conditions and check-in points for determining whether the health system is on track for meeting the first requirement leading up to July 2024. It outlines a pathway for transitioning into a more mature accountability and planning cycle ahead of Budget 2024 (H2022015429 refers), including proposed minimum standards and requirements for the Government Policy Statement (GPS) and the NZHP.

The funding model used for the Budget 2022 transitional funding package provided a useful test case and identified lessons for future work

4. The transitional funding package agreed at Budget 2022 was informed by a model of health expenditure that was based on well-evidenced cost drivers (demographics, inflation, and other drivers such as technology). However, it was not accompanied by detailed and robust "bottom-up" information on planned health service delivery in the interim NZHP (Te Pae Tata). As a result, a portion of the Budget 2022 funding was held in contingency subject to further planning work being undertaken by entities.
5. Budget 2024 will require significant improvement to the methodology and inputs to inform cost pressure decisions. Specifically:
    a. The assumptions for the analytical model used to estimate future health system costs will need revising and updating.

b. The NZHP and supporting information will need to be produced in a timely way and with sufficient granularity to show trade-offs across different funding levels. This means meeting the requirements set out in the companion paper on conditions for shifting to a multi-year funding arrangement from Budget 2024 (H2022015429 refers).

As development work gets underway on Budget 2024, decisions are required on some of the main design features of the multi-year settlement

6. In this paper, we seek your decisions across three main design areas:
   a. **Coverage –** what the multi-year funding arrangement should cover in Budget 2024 and Budget 2027.
   b. **Time horizon –** whether the analytical work underpinning the Budget 2024 multi-year funding arrangement should aim to deliver an indicative medium term funding track for Budget 2027 as well.
   c. **Managing affordability and risk –** how affordability constraints and risks are managed within the multi-year funding arrangement.

Coverage of the multi-year funding arrangement and the funding model

The multi-year funding arrangement should cover all Vote Health funding for Budget 2024

7. Whether funding is included in the multi-year settlement depends on the extent to which funding decisions for each appropriation need to be aligned to the three-yearly planning cycle. Any funding not included in the multi-year settlement would need to be agreed annually through the standard budget process.
8. We recommend incorporating all Vote Health into a multi-year arrangement. It would mean everything included in the NZHP would be covered by the multi-year arrangement, subject to its scope and the sufficiency of accountability and governance arrangements (as per our parallel advice on Budget 2024 pre-conditions - H2022015429 refers).
9. As part of this, we recommend that the non-departmental and multi-category appropriations (including departmental and non-departmental expenditure) for the Ministry of Health are also included in the multi-year settlement. This would establish a consistent approach across Vote Health and ensure that funding decisions for the Ministry are aligned to overall health system priorities that will be reflected in the Pae Ora Strategies, the GPS and NZHP.
10. This spending does not relate directly to health service provision, and costs will not be influenced as directly by drivers of health expenditure. Nevertheless, there are benefits to ensuring that decisions on Ministry resourcing are aligned with the overall system; it will better enable prioritisation and trade-offs within Vote Health on a three-yearly basis. However, we note that this will make cross-Government trade-offs across stewardship, policy, regulatory and monitoring functions more challenging.
11. We have summarised our recommendations in Annex 1.

An analytical model will be developed to help estimate the cost of maintaining health service delivery over the settlement period

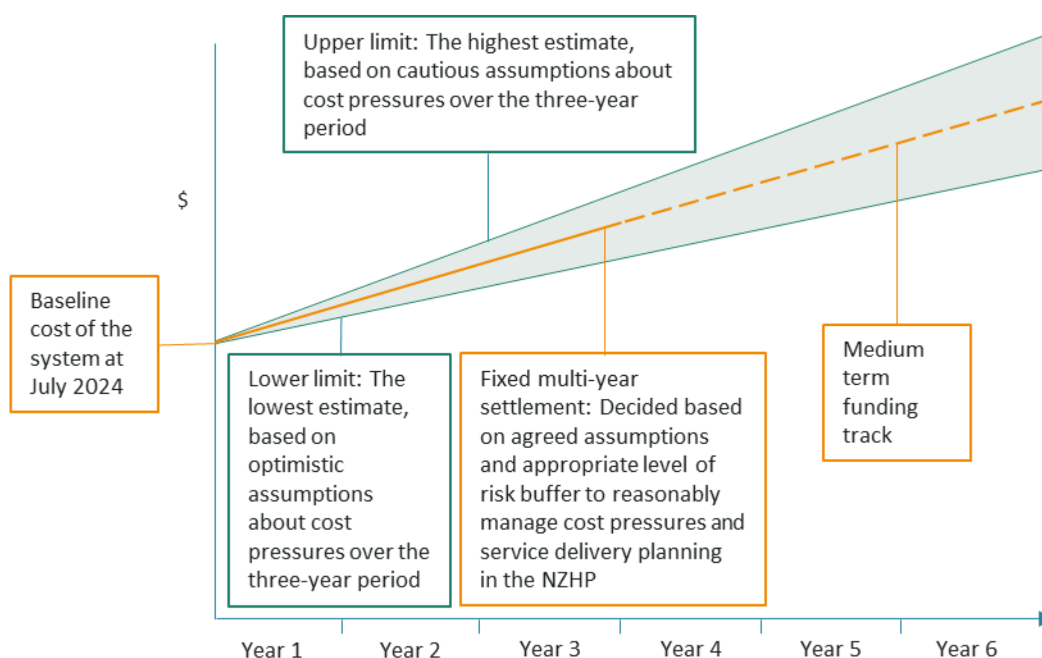
12. The three-year settlement at Budget 2024 will need to be predicated on an accurate assessment of the cost of maintaining agreed policy settings. The upper and lower limits of

this will be developed using an analytical model based on assumptions about demographic change, inflation, technology, and efficiencies. The final decision on the funding level for this 'baseline' cost will informed by both the top down funding model and bottom up information developed as part of the NZHP – illustrated in Figure 1.

13. For Budget 2024, we anticipate that the funding model will be focussed on cost of core service delivery by Te Whatu Ora and Te Aka Whai Ora only.[1] This constitutes most of Vote Health spending. Other health service delivery costs, including pharmaceuticals purchasing by Pharmac and the service delivery costs of the other health entities in the Pae Ora Act 2022, will be analysed separately for Budget 2024. [33] This reflects the additional complexity involved in modelling some of these costs.

14. Note also that some costs are unlikely to become part of an integrated health funding model. These include departmental and non-departmental funding for the Ministry of Health, and other entities operation costs (including Pharmac, and independent Crown entities). These don't constitute health service delivery, and the approach to funding cost pressures in this area will need to align with broader decisions resulting from the Treasury's Fiscal Management Approach review.

Figure 1: Basic overview of the funding model's output



Officials will provide advice on transitional capital settings for Budget 2024 late next year

15. Work on capital settings is on a slower track to operating funding settings, as the design of the health capital system is still progressing. Cabinet approved specific health capital delegations in April 2022 to maintain progress and encourage building maturity and

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[1] There are three appropriations for operating expenditure by Te Whatu Ora and Te Aka Whai Ora: Delivering primary, community, public and population health services; Delivering hospital and specialist services; Delivering hauora Māori services.

capability. A Joint Ministers' report back on capital settings is due in July 2023 (SWC-Min-0063 refers).

16. The July 2023 advice will cover the duration of the budget cycle for health capital in Budget 2024 (3 years vs annual vs a hybrid approach). Based on an initial analysis of options, officials favour a three-year multi-year funding settlement for health to align with the proposed approach to operating funding. This will encourage entities to prioritise forward planning on the capital pipeline. Depending on progress on the National Asset Management Strategy and Investment Plan (expected to be completed in December 2023), we will also seek to provide advice on the balance between a capital funding health pool (with specific decisions at a later point) or a funding pot based on specifically agreed projects.

17. Officials expect to recommend maintaining current settings on health capital charge (this is funded centrally from contingency for all new builds after January 2019) and depreciation for Budget 2024. This reflects resourcing constraints across agencies and provides certainty for capital planning. It will also allow a more detailed look alongside a broader review of health capital settings for Budget 2027.

Time horizon for the funding model

The focus of the Budget 2024 funding model will be on the three-year fixed settlement

18. Cabinet has agreed that the multi-year arrangement at Budget 2024 (and onwards) would comprise a three-year fixed settlement and an indicative funding pathway (the 'medium-term funding track') for the subsequent three years. This was intended to support health sector planning and shape investment prioritisation, particularly where impacts fall beyond the first three-year settlement period. It would also provide a more transparent forward view of health system costs over time (SWC-21-MIN-0157 refers).

19. Health entities' multi-year planning and budgeting is still maturing. Even meeting the minimum requirements for a costed three-year NZ Health Plan will require a significant shift in planning and budgeting, moving away from the annual internal budget process being used by entities in 2022/23 and 2023/24. Therefore, we recommend that the funding model being developed for Budget 2024 focus only on estimating costs for the three-year settlement (2024/25 to 2026/27). We will undertake further work on when it would be feasible and desirable to agree to a medium-term funding track for Budget 2027.

Managing affordability and risk

20. The multi-year funding settlement is intended to be a strongly enforced upper limit on health spending that will support and incentivise better planning and financial control. It will provide health entities with a greater level of certainty over their funding, balanced by a greater level of accountability to clearly established expectations in the GPS and the NZHP. To do this effectively the settlement needs to be designed in a way that creates transparent and commonly understood expectations around risk and variations in cost over the three-year period and minimises that chance that the settlement needs to be re-opened.

21. The composition of the funding track and the multi-year settlement will need to establish processes and settings to manage:

    a. New cost pressures;

    b. Changes in Ministerial priorities;

c. Extraordinary pressures or events that may occur during the three-year settlement;

d. Affordability constraints which may arise before or during a settlement.

22. Our recommended approach to addressing these situations is summarised in Table 2 below and discussed in detail in the remainder of this section.

Table 2: Proposed design features for managing affordability and risk

Situation	Recommended approach
Cost pressures during a settlement period	The multi-year funding settlement should include a sufficient level of risk buffer to manage expected cost pressures over the three-year period without requiring additional funding. There will be choices about the level of the risk buffer and whether all the cost pressure funding should be held in entities baselines (with financial planning demonstrating how risk has been built into budgets) or separately as a tagged contingency held at the centre. Detailed advice on these choices will be provided as part of Budget 2024 decisions.
Changing Ministerial priorities	The multi-year settlement is supplemented by a separate phased three-year, standalone contingency to fund new Ministerial priorities that are identified during the three-year settlement. This would allow for amendments or additions to the GPS as necessary. Detailed advice on the size, delegations and conditions for drawdown will be provided as part of Budget 2024.
Extraordinary events or pressures e.g., pandemic	If there was a genuinely extraordinary event or pressure that could not be managed within the existing settlement, Cabinet could consider re-opening the multi-year settlement. This would require amendments or additions to the GPS. It would include consideration of all funding sources, including any risk buffers/contingencies built into entity budgets, the Ministerial priority contingency and new investment funding.
Affordability constraints before or during a settlement	We recommend setting an expectation with agencies as part of the NZHP development to clearly articulate implications for service coverage/delivery if the funding track is set at a level below what is needed to maintain current policy settings. This will help surface relevant information needed for decision makers around trade-offs in a timely manner.

The settlement needs to have robust cost assumptions and a risk buffer built-in to manage cost pressures that arise during the three-year period

23. The multi-year funding settlement will need to include sufficient funding for health entities to manage variations in cost pressures during the three-year period. This will be important for ensuring that the multi-year settlement is a strongly enforced upper limit on health system spending, incentivising good planning and financial control in entities.

24. The health funding model will establish a mix of assumptions about how cost pressures are expected to evolve over the three-year period – for example, best estimates of inflation, demographics, and technology-driven costs. These parameters, alongside more detailed bottom-up financial and delivery planning in the NZHP (and supporting documents) will establish transparent expectations between Ministers, the monitor, and entities about the latter's ability to manage cost pressures within the multi-year settlement.
25. We recommend a specific requirement for the multi-year funding arrangement to incorporate a buffer for variations in cost pressures, with further decisions to be made as part of Budget 2024 on:
    a. Whether the risk buffer is built into entities' baselines and reflected in financial planning in the NZHP (for example, as an explicit risk buffer in entities' budgets), or is held separately at the centre (for example, as a tagged contingency).
    b. How much risk and uncertainty should be accounted for (i.e., how big does the buffer need to be).
    c. Any conditions for drawing down on a risk buffer (if it is held separately).
26. This buffer would be expected to cover all non-extraordinary risks or cost pressures that emerge during the settlement. Examples might include price or volume increases being higher than budgeted, and unexpected events such as an additional public holiday. It would not cover things like new Ministerial priorities such as pay parity, an increase to the Combined Pharmaceuticals Budget or the direct additional costs to entities of the Income Insurance Scheme. These would need to be prioritised and traded off within the Ministerial priorities fund (see paragraphs 28 to 30 below). It is not expected that this buffer would cover risks that are extraordinary in terms of scale and predictability, such as a pandemic.
27. These decisions will depend on further analysis as part the development of the health funding model, and the quality of information and financial planning that underpins the NZHP. We will provide detailed advice on how the settlement should account for risk, including where any risk buffer should sit, as part of our wider readiness assessments at the Budget 2024 progress checks over the course of next year (H2022015429 refers).

A Ministerial priorities fund would cover new priorities during the three-year settlement

28. In the reformed health system, significant decisions about system priorities, coverage and entitlements are intended to be articulated in the GPS and funded in the three-year settlement. However, it is possible that Ministers will wish to take policy decisions outside of the three-year cycle that have funding implications. For example, if there was a political priority to [33] or increase the Combined Pharmaceuticals Budget. Providing for some flexibility for changes within the multi-year settlement will be important to ensure that such decisions do not come at the expense of maintaining the "baseline" system or undermine the spending ceiling or the integrity of the direction-setting and planning cycle.
29. We recommend establishing a phased three-year contingency fund as part of the new investment package that Ministers can drawdown to invest in out of cycle initiatives aligned with their priorities. There are some detailed design choices that will need to be made as part of Budget 2024 decisions, like the fund's size, conditions for drawdown, and whether it can be accessed by Joint Ministers or through Cabinet approval.

30. Overall, the fund will need to balance the realistic possibility of new priorities with maintaining the integrity of the system's long-term direction set through the GPS and NZHP. This will have implications for its size especially, as too large an investment outside of the three-year cycle could have significant implications on the system's ability to manage long-term outcomes and cost growth.

Extraordinary events or pressures during the three-year period would require Cabinet agreement to re-open the settlement

31. An extraordinary event (e.g., a pandemic) or large unpredictable pressure on costs may require the funding settlement to be re-opened. If this possibility eventuated, Cabinet would be advised on implications including whether the system can absorb the shock within existing funding sources, including the Ministerial priority contingency and reprioritisation of new investment funding. Significant and enduring inflationary shocks (both upwards and downwards) would generally be picked up in the next multi-year settlement.
32. The benefits of attempting to pre-determine the kind of event that would trigger this response are limited. Whether an event was sufficiently "extraordinary" would be dependent on a range of factors (including whether it was isolated to a region or time period; and whether it is accompanied by broader economic challenges) that would be very difficult to predict.

Planning activities need to account for the possibility of a below minimum funding track

33. This could eventuate if the Government's fiscal strategy (or other factors) results in the minimum health funding track becoming unaffordable before and/or during the settlement period. In this case, Ministers would have the option of pursuing reductions in service coverage so that costs can be meaningfully constrained. We recommend that as part of the NZHP development (e.g., when its funding parameters are set in early 2023), Ministers and/or monitors set expectations with entities to articulate implications for the NZHP if the funding track needs to be set at a level below the predicted cost of maintaining current policy settings. This will ensure the right financial information and analysis is surfaced at the appropriate point of the Budget process to support decision making around potential trade-offs in a constrained affordability scenario.
34. There are choices about the mechanism to communicate this with agencies, including via the draft GPS or Treasury's multi-year Budget guidance and templates. On balance, the latter is likely to be the best mechanism as it avoids unduly implying that a reduced affordability scenario is Government policy. Options to significantly reduce health costs in a short period of time are likely to be more limited – so the focus is likely to be on providing clear choices and associated trade-offs over the three-year period rather than from the first year.

The process and timing for developing the funding track will align with the Budget 2024 process

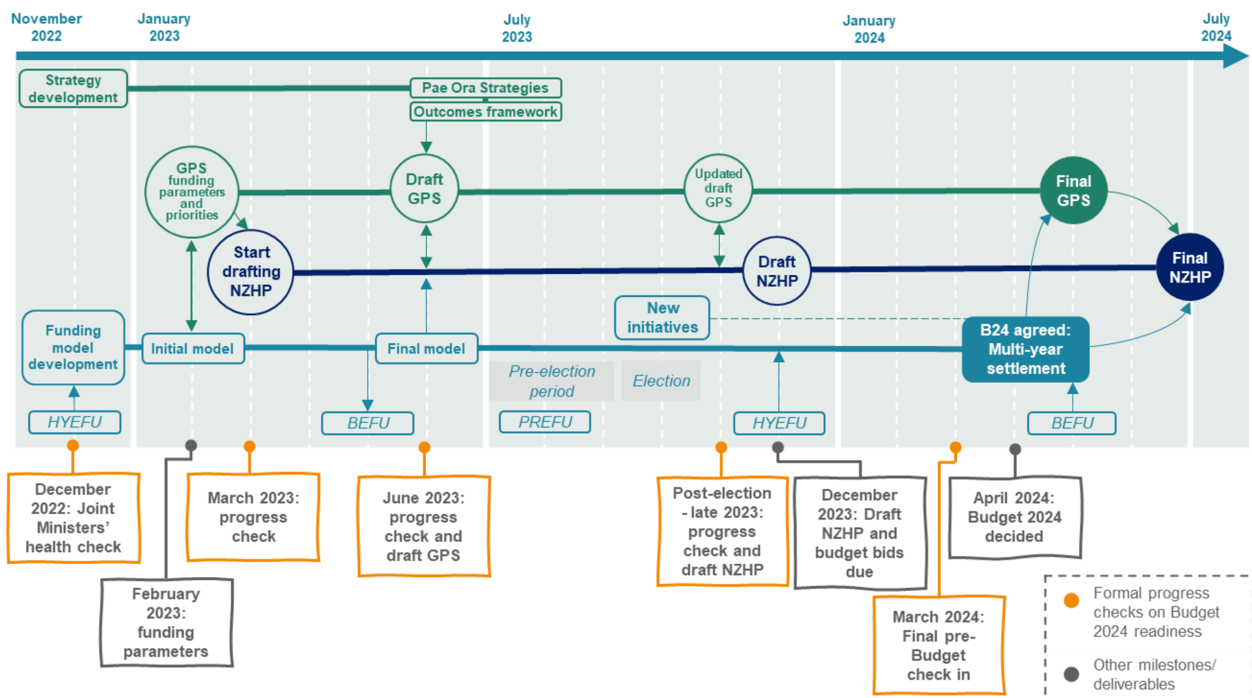
35. Your decisions on this paper's proposed recommendations will provide direction and scope for substantive work to get underway. This is divided into two distinct phases:
    a. Phase 1 – February 2023: Agency teams are working on the first cut of a joint health funding model, based partly on work done previously during Budget 2022. This will

culminate in advice to Joint Ministers on initial Budget planning parameters for the development of the NZHP in February 2023, which will be communicated following the March 2023 progress check-in on readiness to shift to multi-year funding.

b. Phase 2 – March to July 2023: Final refinements to the model, including assessment and development (if relevant) of specific parameters for different appropriations. This will feed into the final parameters for the NZHP.

36. In Figure 2 (below), we set out an indicated timeline with that includes the funding track milestones in relation to the other parts of the accountability framework and Budget 2024 process:

Figure 2: Indicative timeline for preparing the system for multi-year funding at Budget 2024



Equity

37. Historically, funding allocations in health have not always aligned with outcomes sought through long-term models of care. As a result, initiatives and services designed specifically for underserved communities often falter over time because ad hoc funding lacks strategic focus or intent.

38. Among other things, the proposed multi-year funding arrangement is designed to address this by creating stronger links between policy, planning and funding, and encouraging a long-term approach to system planning. This is expected to provide a level of certainty and focus to planners for addressing long-term population outcomes, which will benefit population groups with embedded inequities.

Te Tiriti o Waitangi

39. The long-term benefits outlined in the previous section will apply to Māori communities as well as other population groups.

40. Alongside this, it will be important to reflect the Crown's Te Tiriti obligations through the development process for the main inputs into the multi-year funding arrangement. Two specific areas of note are:

    a. The development of the primary accountability and planning mechanisms – the GPS and the NZHP. Together, these will set system priorities and how baseline services will deliver long-term equitable health outcomes for Māori and enable Māori to exercise decision making authority on matters. There are joint working arrangements with Te Whatu Ora and Te Aka Whai Ora in place which have already been used for the development of this advice. Further detail on the how the development process ties into Budget 2024 is provided in the accompanying advice (H2022015429 refers).

    b. The development of the health funding model and its forecasting assumptions. These will need to be guided by the health sector principles in the Pae Ora (Health Futures) Act 2022 as far as reasonable and practicable. We expect to undertake this work with support from Te Aka Whai Ora and Te Whatu Ora.

Next steps

41. The next Joint Ministers health check meeting is on 7 December 2022. The agenda will include:

    a. A discussion on the recommendations in this paper and the companion paper on coverage and design choices for the multi-year arrangement; and

    b. A progress update from health entities and the Ministry of Health on resourcing, capability, planning and governance to deliver the GPS and NZHP.

42. You will receive further advice on initial Budget planning parameters for the development of the NZHP in February 2023 – as discussed in paragraphs 35-36 above.

Annexes:

Annex One: Proposed coverage of the multi-year funding arrangement

ENDS.

Annex one: Proposed coverage of the multi-year funding arrangement