Examining health funding in Budget 2020

for the Association of Salaried Medical Specialists

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Infometrics

Economics put simply

Authorship

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Biggest boost to the health budget in 10 years

- Health operational funding up 8.0% from last year's budget, with real funding increases for both DHBs and centrally funded services
- However, funding for DHBs only compensates for underfunding over the last three years, failing to make up for the previous seven years
- No signs of capital expenditure to meet hospitals' infrastructure needs
- Overall health funding strong relative to GDP and underlying government spending
- International comparisons of NZ's health spend are mixed, with funding limited by our economic performance and the overall size of government

Total operational funding for Vote Health in Budget 2020 increased by $1,460m, or 8.0%, from Budget 2019. This increase was headlined by $980m of "additional support" in the next year for District Health Boards (DHBs), with the government acknowledging that "as a country we have historically underinvested in Health."[1]

The increase in operational funding from last year's estimated spend is smaller, at 5.4%, or $1,001m. The $459m gap between these figures represents additional spending in 2019 over and above what was originally forecast. However, a significant portion of this additional spending (approximately $265m) relates to the required public health response to the COVID-19 pandemic and is essentially a one-off expense. As such, the 8.0% increase in budgeted operational spending provides a reasonable reflection of the increased funding for health over the coming year.

The summarised figures for Vote Health are contained in Table 1.

Table 1

Vote Health operating and capital appropriations

Budget 2020 compared with 2019

	2019/20 budget	2019/20 estimated	2020/21 budget
Total DHB funding	$13,980m	$14,322m	$15,274m
Nationally administered services	$3,910m	$3,996m	$4,039m
Ministry of Health	$221m	$267m	$250m
Other expenses	$46m	$31m	$54m
Total operating expenditure	**$18,157m**	**$18,617m**	**$19,618m**
Capital expenditure	$1,713m	$883m	$651m
Total health funding	**$19,871m**	**$19,499m**	**$20,269m**
Opex as a % of GDP[1]	5.73%	6.33%	6.67%

1: 2019/20 budget figure is as forecast in May 2019

[1] *Record investment in hospitals and health services*, 12 May 2020.

DHBs really only $400m better off

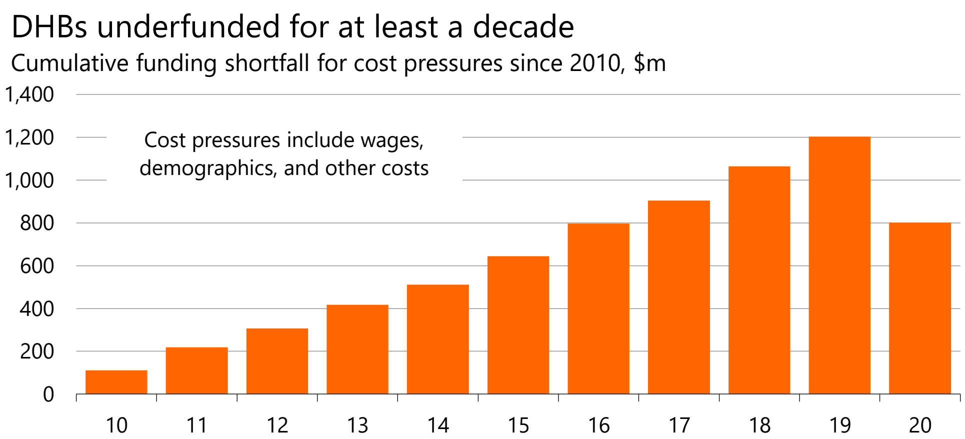
On top of the government's headline funding increase of $980m (equating to $3.92b over four years) for DHBs, there was an additional $30m of funding for other smaller initiatives. Thus the total increase in new funding to DHBs in this year's budget is around $1,010m.

In addition to this $1,010m, DHBs will also receive another $284m for costs that were included in Budget 2019 within the grouping of nationally funded services, but for which the responsibility has now been devolved to DHBs. Most of this funding ($274m) relates to the Supporting Equitable Pay budget line item, which provided for pay equity for care and support workers and mental health and addiction support workers.[2]

Although the government trumpeted its boost to annual funding for DHBs as being the "biggest ever increase", our estimates suggest that DHBs will require $610m of the $1,010m lift to meet increasing wages and other costs during the upcoming fiscal year anyway. In other words, the real injection in funding, over and above required additions, is a more modest $401m (after rounding).

Previous work by Bill Rosenberg and Lyndon Keene for the Association of Salaried Medical Specialists estimated that DHBs have been underfunded by approximately $406m over the previous three financial years. Some caution needs to be taken with previous years' results due to changes in population estimates by Statistics NZ that will have altered the calculations. However, the broad thrust of these figures implies that the funding boost for DHBs merely makes up for the ongoing funding squeeze that had occurred over the previous three years. Estimates for previous years suggest that funding for DHBs fell behind by a further $797m between 2010 and 2016, and this accumulated shortfall has not been made up by this year's funding boost (see Graph 1).

Graph 1

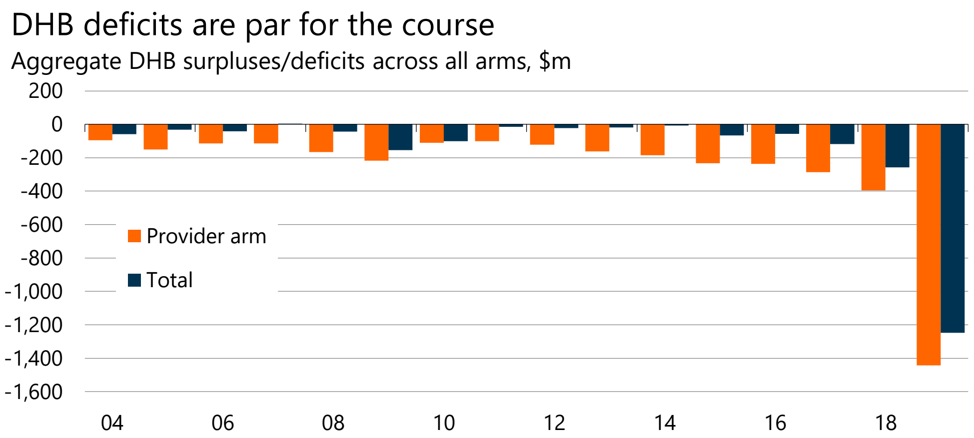


The implication that DHBs are significantly underfunded is backed up by the fact that the DHBs have routinely run deficits throughout the last decade. The aggregate deficit of $1,248m across all DHBs in 2019 was unusually large due and was mostly due to provisions of $590m for compliance with the Holidays Act, with remediation required

[2] Budget 2019 allowed $414m for Supporting Equitable Pay. The remaining $140m is now included within National Disability Support Services.

where employees had not been receiving their correct leave entitlements. Nevertheless, the provider arms of DHBs have run aggregate deficits of between $101m and $395m throughout the last decade, reiterating the funding pressures routinely experienced in the health sector (see Graph 2).

Graph 2



In publicising the funding increase for DHBs, Health Minister David Clark also made the following statement:

> As a Government we've put a significant amount into DHBs to put them back on the path to sustainability. This is a long-term plan, as rebuilding our health system will take sustained investment over a number of years. While we know it's challenging, DHBs will need to work on improving their financial performance as well as continuing to deliver quality care and improved health outcomes. I will be holding them to account on this.

This statement provides mixed messages for DHBs. The government has left the door open to further funding increases in future years, although "rebuilding our health system" also implies that the government could focus its attention on other parts of the system in future budgets. The government has also signalled that it expects improved financial outcomes from the DHBs, suggesting that this year's $980m injection should be sufficient to prevent the DHBs from running deficits in the upcoming financial year.

Whatever the case, the reality is that DHBs routinely require additional funding of over $600m each year to keep up with population growth, demographic changes as the aging population increases demands on the health system, wage inflation, and other cost inflation. Having announced such a significant boost to funding for DHBs this year, the risk is that government budgets in coming years fail to keep up with future demographic and cost pressures, which could quickly undo the real increase in funding that has been achieved in this year's budget.

We also note that, within DHBs' allocations, there is a $10m increase in funding for the Combined Pharmaceutical Budget (CPB) in 2020/21, rising to an additional $50m in 2021/22 and beyond. The immediate $10m funding increase equates to just 1.0% of the CPB, making this year the second consecutive one where funding for PHARMAC has not kept pace with inflation, let alone any demographic or other demand pressures.

More for centrally administered services as well

Funding for centrally administered services such as National Disability Support Services and Public Health Service Purchasing increased by $130m from Budget 2019 to total $4,039m for the upcoming 2020/21 year. Given the devolution of much of the pay equity costs for care and support workers noted above to DHBs, this funding was an estimated $237m more than was required to meet demographic and cost pressures.

This year saw a significant funding increase of $362m for **National Disability Support Services**. Of this increase, $134m relates to the pay equity for care and support workers, while another $5m will go towards transforming the cross-government disability support system. We estimate that $59m was required to cover cost and wage increases, meaning that the remaining $164m represents a real funding boost for this service.

The Supplementary Estimates show the government has topped up Disability Support Services for 2019/20 by $104m with its "Supporting Disabled New Zealanders to Live Good Lives" initiative. Despite the fancy title, this initiative simply acknowledges that the Service has been underfunded for some time and needs more money to meet increased demand and rising prices. Having effectively retrospectively applied the funding increase for 2019/20, this initiative represents a further $79m increase in funding for 2020/21.

National Mental Health Services, which was one of the government's major focuses in 2019, receives an additional $67m in Budget 2020 compared with the previous year's budget. An estimated $61m of this money represents a real funding increase, which is in line with projections from 2019 that showed additional funding being made available for "Expanding Access and Choice of Primary Mental Health and Addiction Support."

Primary Health Care Strategy received a $37m lift in funding compared with last year's budget. Demographic and cost pressures are estimated to account for just over $14m of this increase, leaving just over $22m as a real funding increase and a lift in the level of service being provided. Within these funds, $13m has been earmarked for a free consultation and eye check for SuperGold card holders, with the budgeted funding rising to $62m in the following financial year. There are concerns among GPs that the remaining funding for primary health care is insufficient given the disruption and extra costs faced by doctors due to COVID-19, as well as the potential backlog of patients who have delayed seeking care during the pandemic.

National Planned Care Services received additional regular funding of $29m compared with Budget 2019. Alongside some other small funding changes, the government has specifically allowed $16m extra for demographic changes and $15m to cover increased price levels, which exceeds our estimated requirement of $17m for the coming year.

The government also noted a one-off funding boost totalling over $280m for the next three years to allow for a catch-up in planned care, including elective surgery, following disruption caused by COVID-19.

The other major swing in funding relates to public health. Unsurprisingly, **Public Health Service Purchasing** in 2019/20 is expected to be $229m higher than budgeted, with $227m going towards the government's COVID-19 responses and another $20m of funding in response to last year's measles outbreak. Although the measles response will persist into 2020/21, the COVID-19 costs are not expected to continue. However, the numbers in this part of the health budget are obviously exceptionally fluid given current circumstances, and it is conceivable that the government will need to provide additional public health funding for the coming financial year.

No clear solution for health's capex needs

The Minister of Finance's budget speech highlighted $755m of capital investment initiatives for the health sector over the next five years. All but $5m of this funding is for DHB capital investment and is, at this stage, not allocated to any specific projects. However, this increase in funding for capex does not get underway until 2021/22, leaving total capital expenditure for the coming year at $642m, down $240m from estimated spending for 2019/20.

As far back as late 2017, DHBs signalled the need for $14b in capital spending over the next decade. This figure was reiterated by the Minister of Health earlier this year as being "Treasury's best estimate… and that may well prove to be a conservative estimate." Given that the health sector's capex budget averages $847m per annum over the next four years, there is clearly considerable pressure for more funding for capital works.

Major hospital construction projects in the pipeline include the replacement of Dunedin Hospital (estimated at $1.4b), Stage 2 of Project Maunga at Taranaki Base Hospital (approximately $300m), projects totalling $800m across North Shore, Waitakere, Auckland, and Manukau, and redevelopment work at Nelson Hospital (approximately $150m).

The government's emphasis on infrastructure work to help stimulate the post-COVID economic recovery could see funding for hospital building projects announced outside the regular budget process. Although most of the government's discussion about infrastructure to date has been centred around civil or "horizontal" infrastructure, the COVID-19 pandemic has increased the public's focus on the health system. As such, we believe the government has an opportunity to take significant steps towards improving the health sector's capital stock. Potential capex does not just include the major building projects outlined above, but it should also address a range of smaller hospital infrastructure issues identified by DHBs in their reporting.

Benchmarks look good thanks to funding boost

Treasury expects the economic fallout from the COVID-19 pandemic to result in a 4.6% reduction in real GDP in the year to June 2020. This significant contraction in the economy means that health expenses as a proportion of GDP are now likely to have surpassed the high-water mark of 6.28% recorded in 2009/10, reaching an estimated 6.33% of GDP in 2019/20. With the economy predicted to be stagnant at best during 2020/21, this year's health funding increase is expected to push this ratio up to 6.67% of GDP.

Budget 2020 shows that health operational spending is only projected to increase by $134m between 2021 and 2024. However, we do not believe that this meagre increase, of 0.7% over three years, is an accurate reflection of the government's future funding for health. The government routinely leaves itself a significant unallocated allowance for "new operating spending" in future years, of which a sizable proportion generally goes into additional health expenditure.

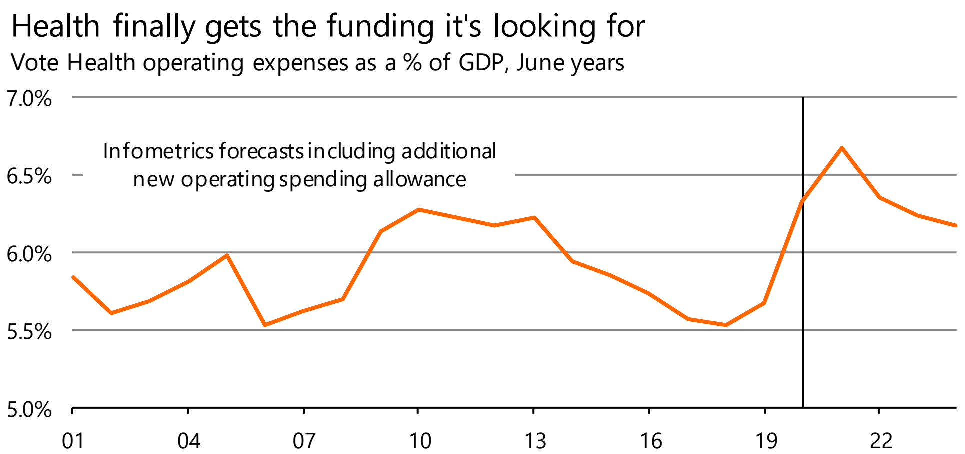
Examining previous government budgets shows that this allowance for new operating spending over the last decade has averaged 5.8% of core government spending three years down the track. This year's figure is even larger, at 7.4% of spending for 2024.

This year's allowance for new operating spending in the intermediate years is unusually large due to a lack of certainty about the government's full fiscal response to the COVID-19 pandemic. Whereas the 2022/23 allowance[3] in last year's budget was $8,818m, Treasury has allowances of between $10.0b and $15.5b for each of the next three fiscal years. Only the 2023/24 figure, at $8,322m, bears any resemblance to the government's allowances in previous years for future spending. We have chosen to work with this latter figure as an indication of how much additional baseline funding is available for government spending over the next three years.

The government's allowance for new operating spending does not generally get evenly spread across all portfolios when it is allocated in future years. Our analysis of budgets over the last decade suggests that, on average, health can expect to receive about 40% of this unallocated money when the budget for 2023/24 is settled on in three years' time. In this year's budget, that 40% allowance represents an additional $3,327m of likely health funding by 2023/24.

Assuming this additional funding is spread evenly across new initiatives throughout each of the next three years, health spending as a percentage of GDP is projected to ease from 6.67% of GDP in 2021 to 6.17% of GDP by 2024 (see Graph 3). The initial decline between 2021 and 2022 is largely a function of the economy rebounding after its COVID-19 contraction, meaning that both GDP and the healthcare spending ratio return to more "normal" levels. The further small declines in the ratio over the following two years reflect that, even with more than $1b being added to the health budget throughout each of the next three years, growth in funding will not be enough to keep up with the expanding economy.

Graph 3



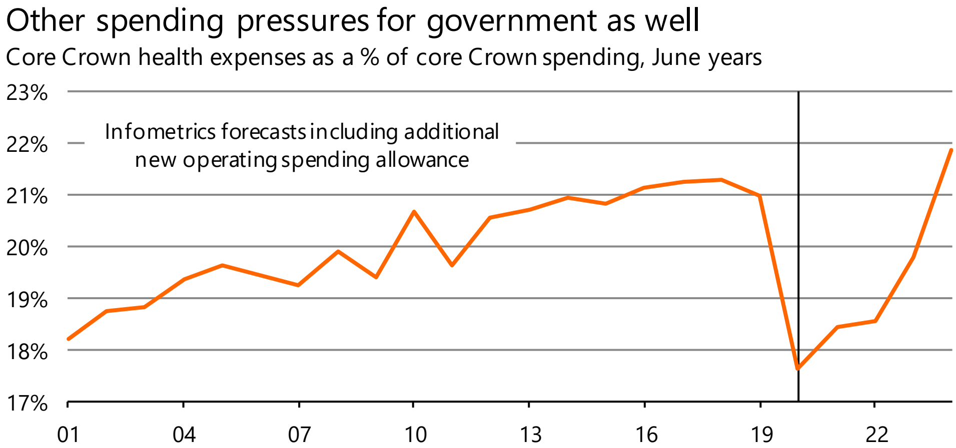
Nevertheless, we note this year's increase in funding places the health sector on a much better path than was previously the case. Even with the slight deterioration in the ratio of health spending to GDP between 2022 and 2024, this ratio will still be higher than at any previous time except the 2010-2013 period.

The massive 31.0% increase in government spending in 2020 due to the COVID-19 pandemic has also distorted our other usual benchmark for health spending, which

[3] We have subtracted the "top-down expense adjustment" from this allowance for new operating spending.

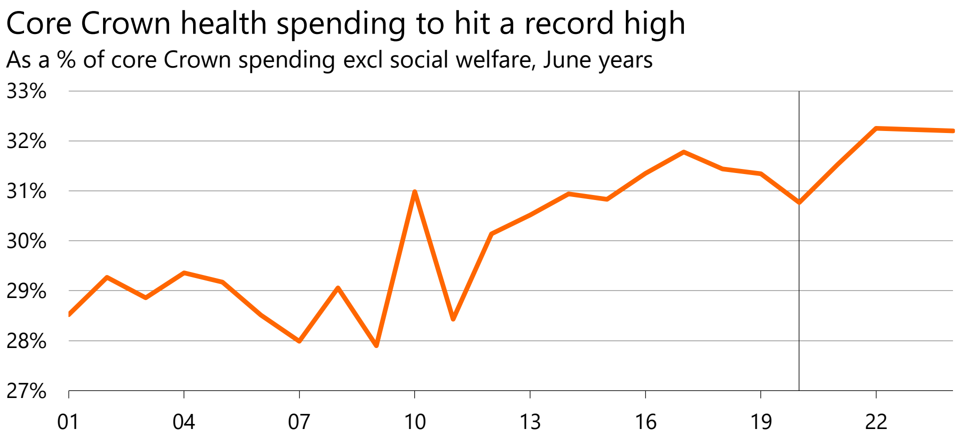
looks at core health expenses as a proportion of total core Crown spending. This ratio has plunged from 21.0% in 2019 to 17.6% in 2020, its lowest level in 20 years. By the time the government's accounts regain some semblance of normality in 2024, Graph 4 shows that the ratio could have recovered to 21.9% of GDP when our allowance for $3,327m of additional health spending is included.

Graph 4



The bulk of the government's fiscal response to COVID-19 in the budget shows through via increased spending on social security and welfare and the unallocated allowance for new operating spending allowance. Excluding these two expense lines provides a clearer picture of health's outlook within the underlying trend for government spending. Graph 5 shows that the ratio has dipped in 2020, partly due to some COVID-related costs coming through in other expense lines such as Core Government Services. However, the ratio is expected to rebound in 2021, and then to exceed 32% for the first time in 2022.

Graph 5



This long-term upward trend in health expenditure as a proportion of total government spending primarily reflects the aging population and the increased demands it places on the health system. Technological advancements over time have also raised people's expectations of the health system and led to greater demands and resource pressures.