THE LEGISLATIVE COUNCIL GOVERNMENT ADMINISTRATION 'A' COMMITTEE MET IN COMMITTEE ROOM 1, PARLIAMENT HOUSE, HOBART, ON MONDAY 5 DECEMBER 2011.

COST REDUCTION STRATEGIES OF THE DEPARTMENT OF HEALTH AND HUMAN SERVICES.

Mr MARTIN JOHN WALLACE, SECRETARY, AND **Mr ANTHONY JAMES FERRALL**, DEPUTY SECRETARY, BUDGET AND FINANCE DIVISION, DEPARTMENT OF TREASURY AND FINANCE, WERE CALLED, MADE THE STATUTORY DECLARATION AND WERE EXAMINED.

CHAIR (Ms Forrest) - Thank you, Martin and Tony, for coming along. What you say here is covered by parliamentary privilege and things you repeat outside may not be. If there is information that you think should only be received in camera, you can make a request for that at the time and we will consider that. The terms of reference are in front of you, and I am sure you have had a chance to look at them previously. I invite you to start the discussion with a bit of historic perspective about how we got to where we are, why, and how the decisions have been made with regard to the need to cut the Budget generally, but particularly in regard to Health.

Mr WALLACE - Essentially Treasury's role is to provide advice to the government of the day on the state of the finances, and particularly what is required to ensure that the services which the Government is responsible for can be provided on a sustainable basis into the future. We provide the Government with policy options advice and we analyse the trends in revenue and expenditure for that purpose. At the end of the day what we're concerned about is the ability of the State to deliver the essential services that it is constitutionally responsible for on a long-term sustainable basis.

The situation in which the State finds itself has been well documented in recent reports, including last year's midyear financial report and the 2011-12 State Budget. Essentially we have a major structural problem or deficit in the State's finances. It is structural in the sense that it is not cyclical because it won't repair itself. The expenditure on services in all the things the State is responsible for substantially exceeds the revenue we have and are projected to have into the future. As is evident from the budget documents, we had a cash deficit total of approximately $500 million in the last financial year and the Government announced a medium-term fiscal strategy to eliminate the cash deficit and return the State over a period of three to four years to a situation where it is covering its recurrent costs, so having a positive net operating balance, and then using that as a platform to build the capacity to fund future liabilities over time. Essentially it is strategy which, by the end of the current forward Estimates, is intended to deliver a net operating balance and eventually an overall fiscal surplus. That is a multi-year strategy.

In providing advice through the State budget process about the options and the ways in which the State was going to return its finances to a sustainable position so that revenue covered our expenditure, we looked at various options and, as you are aware, we are targeting, by the last year of the forward Estimates, savings of approximately $340

million per annum, of which $270 million per annum is from departmental expenditure. About 65 per cent of the savings are from departmental savings strategies and the other 35 per cent are from the other measures the Government announced in the Budget - things such as reducing non-service expenditure, eliminating some tax concessions, increasing dividends for government businesses et cetera.

Basically we had on overall task for savings in agencies of approximately $270 million by the third year - the last year of the forward Estimates. Of that, Health's total by the end of the forward Estimates period is approximately $150 million, and in the initial year it is $100 million. That allocation of savings to the individual agencies was calculated in a way that was, in our view, the most equitable approach to sharing the burden across the range of different government services in order to reduce our expenditure down to a situation where our revenue matched our expenditure. You can't continue in a situation where we have a recurrent deficit for any length of time. That would mean we would be borrowing to fund recurrent services and we'd have a financial position that rapidly got out of control and would make the burden of adjustment even greater for each year that we delayed taking action.

CHAIR - Martin, on that point, you said $150 million was the total for Health savings over the period of the forward Estimates. We've been told that the $100 million this year is not $100 million in real terms; it has been suggested it is a much higher figure. So in real terms, what are we talking about cutting out of Health in this year and then the forward Estimates?

Mr WALLACE - From our perspective, from the way in which the figures are calculated, the ask is $100 million in savings.

CHAIR - That doesn't take into account the budget overruns, though?

Mr WALLACE - The way in which you can calculate these numbers can be done in various ways. The way in which it has been calculated in terms of the share that each State department has is that Health's ask is $100 million.

Mr FERRALL - The only issue I think you are considering is Health, which, like all government departments, has a range of pressures internally which they are also managing. When you're looking at the figures that Health was advising in terms of additional savings, you have picked up those issues which are effectively internal cost pressures that they're managing.

CHAIR - They have put it to us that the $100 million required for this year does not take into account the $60 million overrun they had last year, so effectively they have to save the $100 million plus the $60 million overrun. Are you saying that's not the case?

Mr FERRALL - No, that's not the case.

Mr WALLACE - I read the *Hansard* and that wasn't my understanding of what they were saying.

CHAIR - They were saying that in real terms it was much more than that requirement of $100 million?

Mr WALLACE - Effectively they were funded for any overrun in the previous years and the funding was indexed. Then after that the budget savings were taken off, as happens with all agencies.

CHAIR - The Southern Area Health Service, the Northern Area Health Service and the North West Area Health Service all said that the percentage savings of their budgets was 10 per cent for southern, 7 per cent for north and 10 per cent for north-west, but they said they were 15 per cent in real terms for the south, 14 per cent for the north and 13 per cent in the north-west.

Mr WALLACE - We would rely on them to explain what those numbers are, but in terms of the numbers that we see in the Treasury department in relation to their level of expenditure in previous years, the budget ask is $100 million. If they have hidden costs because they have commitments from the past that play out into the future, they are the only ones who can work out what that number is, so I'm not quite sure whether the number you're talking about includes those sorts of things.

CHAIR - Well, that's what they indicated. As I understood it - and you have read the *Hansard* so you know what they said - they said that the $100 million is the headline figure, but there was a $60 million overrun last year in Health and because their budget was $60 million less than they spent they were required to make that additional saving of $60 million.

Mr WALLACE - I don't quite know how they got those numbers.

CHAIR - So you haven't had discussions with the department about that?

Mr WALLACE - Yes. We have worked with them in relation to the identified $100 million in savings strategies to deliver their budget for this year and the following year.

Mr WILKINSON - Martin, would that be taking into account the fact that you believe they were of a certain figure at the end of last year and, as a result of the figure that you believe they would be last year - and we are told they were last year - you estimated that they had to make $100 million savings on the budget figure?

Mr FERRALL - That's not correct. There are a whole series of adjustments that were made to Health's budget between the 2010-11 Budget and the 2011-12 Budget. In broad terms, those adjustments were, for 2011-12, additional funding provided of $122 million; midyear financial report savings - you would recall that when the midyear report was introduced there were a range of savings that were shown there - of $7 million; budget savings strategies of $7 million; a series of parameter adjustments of positive $41 million, and also indexation and other depreciation adjustments of $2 million. So there is a whole series of ups and downs between the 2010-11 Budget and the 2011-12 Budget.

Mr WILKINSON - So Treasury would be content if there was this $100 million saved out of the Budget from Health at the end of the financial year?

Mr WALLACE - We would expect that Health and Human Services would meet its budget provided for the year. The estimates that were calculated on the basis of expenditure patterns were that savings measures - so this is after a lot of adjustments in the budget process - at the end of the day they needed to identify $100 million worth of savings.

CHAIR - On their 2011-12 budget figure?

Mr WALLACE - Yes. As I said before, the extent to which there are some underlying commitments that relate to their previous budget - underlying deficits for whatever purpose or forward commitments of expenditure - their assessment of the number could differ from what we're monitoring but at the end of the day the requirement is that they deliver their budget.

Mr WILKINSON - No doubt you're in fairly regular contact with them, so do you believe at this stage, with the information you have, that they are on target to meet that $100 million worth of savings?

Mr WALLACE - I noted what was said in the *Hansard* by Health and Human Services. I think they said about $92 million of the $100 million was on track and there was $8 million at risk. The Government also put out the first quarterly report to the end of September where it was identified that Health meeting its current budget was a high risk because there are a range of pressures happening as well as just meeting these budget tasks. At the moment we are hopeful and we are working very closely with the agency. We are hopeful they will meet their budget. We believe they can and we believe if they don't it is purely a timing issue - that is, the strategies that are put in place have either delivered the savings slower than was expected or they started later than they ideally wanted to, so at 30 June if there is an overrun we are hopeful that is purely a timing issue and within the next few weeks they have achieved 100 per cent of their savings strategies. Because it is a three-year plan, that shouldn't mean an adjustment to the next two years; it should mean that basically there is a catch-up so that by the end of the forward Estimates period it is on track.

CHAIR - If it doesn't come in on track - you have identified at least $8 million that is at risk - what action will Treasury take at the end of the financial year if it is at least $8 million they haven't been able to save?

Mr WALLACE - It really depends on the nature of the problem. We ideally want them to hit their budget by 30 June, but if it is a timing issue and they are not achieving the full value of those savings strategies for a few weeks after that then that is basically a catch-up they would do. Because the task next year and the year after is nowhere near as big as the task for the first year, from our point of view we would be on track to deliver the State's financial strategy. If there were a range of other factors that are impacting on this - and it is too early to say what they are at the moment - we would be recommending appropriate approaches to government. But because we don't know at this stage, we can't comment on that.

CHAIR - There's been a lot of concern that cuts to elective surgery in particular will push the cost of that surgery out to a later time, perhaps two or three years hence, maybe outside the forward Estimates, so doesn't that put that whole timing issue in another light? Those

costs will inevitably be there, it will just be a matter of timing for them, too, as people present as emergency cases or eventually they will have to have their surgery done.

Mr WALLACE - They are questions for Health and Human Services, not Treasury. Health and Human Services have identified their savings strategies in that particular area and what they're seeking to achieve.

CHAIR - So Treasury gave no instruction as to where the cuts could be made or how much could be made in any particular area? You just said, 'This is the amount of money you have to cut from the budget and how you do it is up to you'?

Mr WALLACE - Yes. What happens with each agency is that a budget saving target was identified and then strategies to achieve that were identified and agreed. With Health, there were $30 million worth of identified strategies and then an amount of around $70 million which was for them to identify after they had worked through a number of issues to find the most effective way of delivering that saving. These are in that latter category, so they are ones that the department has identified. As you know, the secretary takes advice from the business control team, which is there to help the agency with the management of its budget. It's an advisory body and Treasury and Premier and Cabinet are represented on that body.

Mr FERRALL - As Martin said, the business control team is advisory to the secretary of the department, so it didn't have a formal role in identifying specific strategies. The department allocated the $100.2 million across various business units within the department and each of those business units brought back strategies or proposals to meet their component of the savings. They were referred to the business control team, not for approval but as part of a consultation process. The secretary in many cases took those forward to the minister on the basis of whether they had political or other implications, but some of those strategies would not necessarily have gone to the minister at that point. Subsequently, the minister has published all the identified strategies on the Health and Human Services website.

CHAIR - So you're saying there was $30 million that was identified by Treasury?

Mr WALLACE - No; agencies were given a budget task and they had to identify strategies to meet that budget task as part of the budget process. So these weren't things that Treasury suggested; agencies suggested it. In the case of Health and Human Services, there was an initial $30 million of specific strategies that were identified and agreed, but then because of a range of things, including the national health reform, the move to the local area health networks, the need to move to a nationally efficient price over time and review of other services, when we published the budget documents they still had to identify and have agreed some individual savings strategies, which is what Tony is talking about - the $70 million.

Mr WILKINSON - I know times are tough and there's not much cake to share around, but can I talk about the public account very briefly because it would seem to reflect on whether the savings might have to be increased in the next couple of years. One could look at the public account, and I had a brief one last Thursday, we note that the public account now is down to $159 million, from the end of 2008 where it was about $1.246 billion. So in the three years approximately the cupboard has been emptied by

more than $1 billion. When one looks at that figure, am I being too simplistic to say, when we are now $159 million as opposed to $1.24 billion, there are rocky times and even rockier times ahead because of the amount of spending that has occurred over those last three years?

Mr WALLACE - It has been made very clear, or we would hope it has been made very clear, in the midyear financial report that there has been a substantial cash deficit for the last two years. The Government has explained this as taking the 'hay out of the barn', effectively borrowing internally to meet those deficits. The strategy aims to ensure that we don't go into a spiralling debt problem by continuing to borrow for these deficits. When the money runs out internally we're borrowing externally to fund those deficits and, as we all know, it is very easy then to get into a rapidly escalating debt spiral where you don't even have enough money to pay the interest, so you capitalise the interest and compound the interest and the situation becomes very much worse very quickly. The strategy is designed to ensure that we don't have a cash deficit on our recurrent account - in fact on our total expenditure and receipts of funds. That's what the strategy is all about. My personal view is that the Government has been quite open about the fact that there is no hay left in the barn. Unless we can achieve this, we will be into external borrowings and that will increase rapidly, so that's what the aim of the strategy is.

Mr WILKINSON - In the last 12 months, though, it has been reduced from $620 million down to $159 million, has it not?

Mr FERRALL - I'm assuming what you're talking about is the balance of the special deposit trust fund which was effectively $620 million and you're taking off $424 million, which is the Australian Government -

CHAIR - Which you can't use for anything else.

Mr FERRALL - So that is your $190 million. The balance as at 30 June 2010 was $938 million and it has fallen as at 30 June 2011 to $620 million.

CHAIR - But that counts that money from the Australian Government, though?

Mr FERRALL - Yes.

CHAIR - Which includes the Wilkie money.

Mr WALLACE - It's consistent with the cash deficit.

Mr WILKINSON - So they are moneys which are recurrent expenditure?

Mr FERRALL - As Martin indicated a while ago, we are running a recurrent deficit and the deficit has been funded in recent years by drawing down on cash reserves. Once those cash reserves are depleted, you have no option but to fund by external borrowing.

Dr GOODWIN - I had a question in relation to the approach taken to work out how to share the burden across the agencies? I think you mentioned there was an equitable approach and some sort of methodology. Could you elaborate on that?

Mr WALLACE - Having identified the cash gap to get down to a situation over the three years of the forward Estimates to eliminate this deficit, and after taking off the other measures, we identified what services, what departmental expenditure, would be needed to contribute to the difference. The task was allocated by looking at the Consolidated Fund recurrent allocations of the agencies, less administered payments and working that out as a proportion of the total. We had to take into account the fact that of the previous strategies some agencies had delivered on them and a couple had not or still had work to do, so as not to penalise agencies that had delivered their strategies we made an adjustment to that basic calculation to reflect an extra ask on two agencies on top of that allocation. Over the three years the percentage reduction in agency allocations is roughly the same, except for Education and Health that have a slightly bigger ask because they had savings measures from the previous budget that hadn't been delivered or were in the process of still being delivered. So it was as equitable as we could find to share this burden, while providing appropriate reward for and recognition of areas where the cuts had been greater in the past because those agencies had met their budget strategies.

Mr FERRALL - At a global level what we did was start with the midyear report and net operating balance and then targeted the level of net operating balance that would be required across the forward Estimates in order to meet the fiscal strategy and prevent the net debt situation from arising. That was then fed in to create a global figure and then we allocated that across agencies, as Martin described.

CHAIR - So some other departments had to make savings post-2008, I assume, at the first indication that cuts were going to be made. Are you able to provide a percentage of each of the various department's budgets that have been cut or required to be cut since 2008 through to the forward Estimates period now?

Mr FERRALL - The short answer is yes. The more complex answer is related to having a clear understanding of what is in a department's budget. If you're talking about simply asking the percentage figure as compared to, say, the Consolidated Fund allocation, that would give you one set of percentages. If you look at a department's budget, Health as an example, its budget is made up of a number of components: a Consolidated Fund recurrent component; a Consolidated Fund capital component; a set of figures for own-sourced revenues, which vary; some Commonwealth funding which is paid directly to the department; funding that might come from Treasury from funds such as the ESIF or similar - so there are transfers in there as well. When you start to compare across all departments you need to understand what all those various components and changes are in order to compare the figures directly, otherwise you get variations which are driven by changes in revenue. For example, last year Health's own-source revenue was about $8 million more than its budgeted figure. So if you start comparing end of year to budget and then compare than to another agency, you get variations and you need to know that components to explain it.

CHAIR - Can we look at one particular area, then - the staff costs, wages and employee entitlements. The Auditor-General found in his report on the Treasurer's annual financial report that employment numbers have continued to grow at 4 per cent per annum since 2008 or before that, so if we are looking at recurrent costs of staffing and employee costs, that sort of information could be more readily provided and you'd be comparing apples with apples there, wouldn't you?

Mr FERRALL - You would be, and certainly at the Estimates committee we flagged that employee numbers had increased significantly over recent years. You also have to be careful that some of the employees are funded from other sources of revenue as well, so again on the margin you still get variations because of that. You could compare employee numbers or employee costs, so you want us to compare the employee costs -

CHAIR - From 2008 onwards and for the forward Estimates. In 2008, I am sure you can remember, the former Treasurer said they were going to cut 800 positions and it seemed very little of that happened. Employment continued to increase across the public sector at 4 per cent per annum. While some positions might have gone, there has been growth in other areas.

Mr FERRALL - I only have a figure from 30 June 2010 - FTEs were about 25 000 and they'd grown from about 20 000 in 1999-2000; so there has been continuing growth in employee numbers. In addition to the changes in employee numbers over that period, there have been significant changes in employee wage rates. These are from the CPE annual report, so at 30 June 2010 it was 25 001 and at 30 June 2000 it was 20 166.

Mr WILKINSON - Do you know approximately what it is now?

Mr FERRALL - At 30 June 2011, 25 452. We've got to be a little careful with the way these numbers move because it depends whether you have counted police. Police are not necessarily considered State Service employees in those things, so I am not 100 per cent sure that this series is directly comparable to the 25 001.

CHAIR - Is this FTEs or people?

Mr FERRALL - FTEs.

CHAIR - Are you able to provide that clarification to the committee?

Mr FERRALL - We can get that.

Mr WILKINSON - In relation to health, are we able to have a breakdown of those figures as well?

Mr WALLACE - It depends on how the public sector management office break down the numbers.

CHAIR - Across all departments; it would be good to have that comparison.

Mr FERRALL - Yes.

CHAIR - If we go to Health's $8 million increased own-source revenue, where did that mostly come from?

Mr FERRALL - It was against budget.

CHAIR - Yes, but where did they grow it? Was it in private patients using the hospital or DVAs or -

Mr FERRALL - You would have to ask them. It is the end-of-year actual versus the budget and you have to recognise the budget is formulated some time earlier so it might not necessarily be growing revenue per se. It might just be that the original budget estimate they did was lower than it potentially could have been.

CHAIR - Is it a fair comment to say that you cannot rely on that? Health officials said that private patient revenue was one area they were trying to maximise, making sure the people who were privately covered did actually declare it and use it so they could charge them for it, but if we are closing medical and surgical beds and cutting back on elective surgery then it seems logical that you are not going to fit as many patients into the beds, certainly not for elective surgery which is generally where your money is from private patients. Going into emergency, most of them would not choose to go into private because you have no choice anyway as an emergency patient.

Mr FERRALL - I cannot comment on how Health's revenue is travelling this year compared to budget. The last report from our normal liaison has indicated that they are on track with their budget so I cannot comment on whether it is going to be up or down as at the end of the year.

Mr WALLACE - I presume they would have taken that effect on their budget into account in identifying these particular strategies they were going to follow.

CHAIR - The point I am making here is that last year, Tony, you said the budget was effectively out by $8 million in own-source revenue and this year you could expect that to drop if some of that was reliant on private patient throughput, which would be a reasonable expectation, so potentially that could add a few million dollars to the task if their budgeted figure is more accurate this time. I know it is a guess and we do not know how many private patients are going to come in. Is this part of the reason why they are saying that $100 million is the figure but if they do not get $5 million they are expecting through own-source revenue then that will make it at least $105 million.

Mr FERRALL - I was not trying to make a comment in terms of whether their revenues would be up or down this year compared to budget. I was flagging that there are a whole number of factors that make up the department's budget and through the year some of those move up and down. Your point effectively is that if their revenues are lower than budget then they may have an additional budget task.

CHAIR - Yes.

Mr FERRALL - That is not necessarily true because, whilst the revenues may be lower, it could be that their cost structure is lower as well. So, you can't necessarily say that simply because revenues have gone down that they will have an additional budget task or, conversely, if revenues were up that it would reduce their budget task - because it depends on what the costs are on the other side of those revenues.

Mr HARRISS - Tony, reflecting on what the departmental officials shared with us, they indicated that their best assessment suggests to them that they are $8 million off target right now and that they have to look at how they are going to address that. Right at the moment they are saying they will fall $8 million short. What will be their position or the

position of any other department if that holds true? In Health's case we are only a couple of months into the financial year and they are saying they are $8 million off target. If that explodes, what does that do from a Treasury perspective to the Health department?

Mr WALLACE - I touched on this earlier. My understanding is that this is a projected picture for them so they are saying that, of the $100 million this year, there is $8 million at risk to get them to the end of the year.

Mr HARRISS - Yes.

Mr WALLACE - So I don't think they are saying we have not achieved $8 million to this point in time.

Mr HARRISS - That's right.

Mr WALLACE - From our perspective the main issue is that if they do not hit the target for 30 June, how soon after that will they effectively hit it. This is all about a set of strategies that deliver savings, so on that assumption if they haven't hit their budget it is because their savings from these strategies haven't built up to the level they are supposed to by 30 June. So it could be just a timing issue. As I said before, if it is just a timing issue then it just means that in the next year and the year after that of the strategy they would need to catch up. So it is not the end of the world from our perspective. Yes, we do everything we can to ensure we come in on budget each and every year, but in relation to the fiscal strategy and Health's role in it we would hope that this is a timing issue of very short duration. If you measure from the beginning of the year to the end of the year to generate $100 million in recurrent savings, you could be $10 million short on 30 June but have caught it up two weeks later.

It is too early to specify the nature of the overrun, if any. As we get more into the year to understand that then we would be providing advice to the Government about what options they might take in that situation. As we have heard them say, of the $100 million they are confident of about $92 million and they see the other $8 million as at risk.

Mr HARRISS - What is your process in terms of communication with departments and specifically Health? Is it weekly, monthly? How or what sort of reporting process do you require of departments back to Treasury as to hitting targets?

Mr FERRALL - We have a range of meetings with all departments. As a minimum we would be meeting with their CFOs on a monthly basis across departments.

Mr HARRISS - Normal?

Mr FERRALL - Normal, and our budget analysts would have a whole range of other communications between those meetings, but we try to meet with every agency on a monthly basis. With Health obviously there has been a much more intense process. It is much more significant in the issues that we are trying to deal with and they are much more complex in terms of understanding. With Health, I am part of the business control team and to date there have been 13 meetings of the business control team and at that meeting the department's budget is discussed and how they are travelling on their saving strategies. These meetings go back to May so it was through the period of developing

and identifying particular strategies. A further three meetings are planned for December. So it is about every two weeks that I have been involved with these meetings. Between May and the end of this year there will have been about 16 meetings with the department so there is quite a lot of interchange with the department. As I said, the earlier meetings were around their identifying and developing the various budget strategies that were put forward.

CHAIR - The Health department call it the 'budget control team'; you are calling it the 'business control team' but I assume we are talking about the same thing.

Mr FERRALL - Yes.

CHAIR - Who sits on it, what are the terms of reference for the team and how does the team actually operate or what authority does the team have?

Mr FERRALL - As I said earlier, the business control team is advisory to the secretary, so it doesn't operate under legislative or any formal authority of that nature. Effectively the terms of reference were to ensure that there was an appropriate governance framework to achieve the required level of savings and to deliver an efficient, sustainable future. The business control team basically works within a framework that provides expert advice and support to the secretary as necessary, so we will effectively do what the secretary might consider appropriate or necessary.

CHAIR - The secretary of the department?

Mr FERRALL - Yes.

CHAIR - Who is on it?

Mr FERRALL - The secretary of the department or acting secretary, as is currently the case; the chief financial officer; a representative of Premier and Cabinet -

CHAIR - Who is that?

Mr FERRALL - It was Greg Johannes until he changed over. It is John McCormick at the moment. There is myself from Department of Treasury and Finance. Also there are other members of the department who attend as necessary, depending on the sorts of issues that are being raised. So it can be the Deputy Secretary of Children, or Deputy Secretary of Health and Hospitals or the Disability Deputy Secretary. Also the hospital CEOs have attended at various meetings depending on the nature of the issues that were being discussed.

CHAIR - Are you able to provide copies of the minutes for those meetings and any communications in between to the committee?

Mr FERRALL - I can't because the department holds the minutes.

CHAIR - Who chairs the team?

Mr WALLACE - The Secretary of Health and Human Services.

CHAIR - Has Treasury provided any direct advice about managing the situation to the business control team - directives, letters, memos and that sort of thing?

Mr FERRALL - There has been correspondence, yes, but most of the advice, if you want to call it that, from Treasury comes through me in an oral form at the meetings. So I would look at some of the issues they have raised and make comments at those meetings from a Treasury perspective to the secretary, who would then take that on board.

CHAIR - So do you ever follow up the meetings with a letter, a memo or some other correspondence back to the business control team?

Mr FERRALL - I think there was only one occasion where we have written to the department.

CHAIR - Are you able to provide a copy of that correspondence to the committee, and any others if there are any?

Mr FERRALL - Yes.

Mr HALL - You talked about the 13 meetings you have had so far and three to go before the end of this calendar year. What are the main areas of concern that you have identified and where are they at this stage?

Mr FERRALL - I don't think I'd say there are particular matters of concern. Certainly, from a Treasury perspective we have been pushing quite hard for the department to identify budget strategies and to implement them as soon as possible, to identify the actions necessary to achieve some of those strategies, to prepare detailed plans where necessary for those strategies because, in some cases, they are not things that you can implement overnight. Some of these strategies involve a long period of time. So without saying they have necessarily been concerns, the sorts of areas that I have been raising are the importance of having proper plans, of having clearly identified strategies, of having individuals being held accountable for those strategies where appropriate, and ensuring that all matters associated with a strategy, such as potential industrial relations matters and others, are well managed and within the framework of overall governance.

Mr HALL - I acknowledge all of that but within the Health budget at the moment are there any glaring examples in a particular hospital or whatever which are out of whack more than anywhere else?

Mr FERRALL - No, not from my perspective. As we stated earlier, the department has been slower in advancing or implementing the strategies from a Treasury perspective. I think even the acting secretary made the same comment that they would have liked to advance the strategies more quickly than they have been able to, but these are complex issues. It is easy to say you should get them done quicker but they had to go through a lot of work internally to actually understand them and understand the implications of them.

Mr HALL - So at this stage there are no real alarm bells ringing whereby, say, particular parts of the Department of Health are not being blown out further, if you like, or not able to make their budget saving strategies?

Mr FERRALL - No. There is a lot of pressure on and it will be difficult for many areas of the department to meet the necessary savings strategies. Their best assessment internally at this point is that they will have advanced all of the strategies within the time frame but they have, as identified previously, about $8 million they believe is at risk. From my role on the business control team I can't really add much more than that because what we get is the information that the department deals with internally. So I can't really provide a better assessment than the department can in terms of its position.

CHAIR - So you haven't felt the need to put a red flag on anyone's notes to say 'watch this carefully'? You have had 13 meetings so far, so is there a red flag on any of those files?

Mr FERRALL - I can categorically say there is not a red flag on any files.

Laughter.

Mr FERRALL - I reiterate that from a Treasury perspective we see the department is under pressure in terms of trying to meet its strategies. That was clearly identified in the September quarterly update report, that there are a range of pressures. We would say there is a risk that they may not be able to achieve all of the strategies within the time frame. So to that extent, yes, there is a set of concerns, but in terms of identified individual strategies or whether I have a particular concern about a particular budget area or budget unit or hospital, no. It is more a global issue of whether they can achieve their strategy later on.

CHAIR - So if we called you back in March or April next year and asked the same question, you would expect by that stage of the financial year that it would be more evident?

Mr FERRALL - The nature of budgets and departmental performance against budget and even whole-of-government performance is such that on 30 June you know exactly, and as you go back further from that point you will have a greater degree of inaccuracy. When we release the midyear report, which will be in early February, that will be a more comprehensive assessment of where all departments are at. At that point you do tend to have had much greater information. In the first couple of months of the year from departments there are a lot of variables. There are a lot of issues from the last year that are still rolling over which they are still trying to understand and it usually takes until the midyear report before you can get a detailed assessment and a more accurate projection of what the end-of-year outcome might be.

Dr GOODWIN - I am still trying to get clear in my head what the process has been from the start. I get the point that the agencies were given the targets that they had to meet and it was up to them to identify their list of strategies and obviously get the sign-off through the minister, but what other involvement did Treasury have in that process? Did they also have to get the tick off from Treasury or did they get advice or was it completely up to the agencies and the minister to decide the strategies?

Mr FERRALL - I guess there are a couple of levels on this. For many agencies, strategies were identified and published in the budget. They were quite detailed and all of those strategies were identified by the department, considered by the Government, effectively by Cabinet, and then they became part of the identified budget process. For Health, there was about $70 million where specific strategies had not been identified and they were the strategies that were developed by the department, discussed through the business control team, ultimately approved by the minister and then published on the website. They are the ones the department is advancing. So it is a bit of a mixture.

Dr GOODWIN - In terms of the savings that Health has been expected to find - $150 million over the forward Estimates and then $100 million up front - was there any reason why they were asked to find $100 million in the first year?

Mr FERRALL - At a whole-of-government level the savings targets in any particular year were based on Treasury advice in terms of the most appropriate net operating balance in order to achieve the fiscal strategy. So that is really why you ended up with requirements for early savings because the impact flows through the forward Estimates on that basis. So that is why ultimately it is driven from the net operating balance and attempting to achieve the fiscal strategy.

CHAIR - The net operating balance is a poor measure, though, because it includes all your Federal government funding that comes in and it doesn't include the outgoings.

Mr FERRALL - I probably simplified it a little. When we are dealing with the net operating balance we take into account all the fiscal strategy targets, so that includes not going into net debt. We considered the underlying operating balance, so we considered that range of things. In terms of actually generating the departmental targets, it is really driven off the net operating balance, but we considered all those other aspects in coming up with those targets.

Mr WILKINSON - I have spoken to a number of doctors in recent times, one this morning, and some say that if you are going to properly restructure, there is an upfront cost and then savings made at a later stage, because there are certain decisions that have to be made in relation to, for instance, do you do vascular surgery on people who continue to smoke or do you carry out surgery on people over a certain age in relation to certain operations et cetera. They are the hard decisions, politically extremely difficult to make, which in the end may be the only decisions that should be made in order to properly deal with the spiralling costs of health. However, to do that you have to firstly have a review to see which path you can go down, rather than just saying, 'We have to save money, therefore we are restructuring; restructuring means we are going to save $100 million this year and $150 million the next'. In order to properly deliver on health there has to be a review made on, say, restructure. Let's see what we should be doing in years to come, otherwise we are probably going to have the same argument or discussion, year in and year out. What do you say to that?

Mr WALLACE - If you are going to make major sustainable structural change, that's something that takes a period of time; there is no question about that. That is why the strategy isn't to solve the State's financial problems in one year; that's why the strategy is three to four years to get to a certain point and then to build from that. I have heard those sorts of comments all the time and, of course, I used to work there myself. It has always

been the case that the increase in health costs are unsustainable for any State government. When our revenue was running at 5 per cent per annum, our health budget was increasing at more than 10 per cent per annum and it was a third of the budget; now it is 40 per cent of the budget. Our revenue going forward looks like about 3 per cent per annum. So those difficult decisions always have to be made and there has been a lot of money in terms of increased allocations put into health over the last five or six years, yet everybody knows that we have to find a solution to this problem because it is completely unsustainable to have 40 per cent of the budget increasing at twice the rate of our revenues. So what is actually stopping that happening? What was to stop it happening five years ago, four years ago, three years ago; why is it suddenly a decision now? In any system, whether it is health or education, you are ideally looking at things to make changes to get your services on a sustainable basis.

So the general statement is true. There has been a lot of money provided in the past that could have been used as an investment in future service delivery models or policies that reduce the growth. It is easy to say and it is not so easy to do because you have the Commonwealth interaction in health, as you know, which is very -

CHAIR - Interesting.

Mr WALLACE - Interesting, that's right. So the ability of States to make decisions that they might ideally think were in the public interest is not easy, given the interaction of the Commonwealth and Commonwealth funding and agreements with health that happen at all sorts of levels. A lot of these policy decisions have actually come about because of the requirements of the Australian Healthcare Agreement or whatever it might be. The general proposition is right but we have not been able to find a solution to the problem.

Mr WILKINSON - Is that the debate that is going on around the country in relation to health?

Mr WALLACE - There is no question it is, from a Treasury perspective, because all State treasuries are very concerned about sustainability of State budgets, given this growth in costs in the health system. To varying extents they are all significant in terms of their budget and they are all increasing at a much greater rate than revenue for each State. So, yes, it is a serious debate and particularly so at the moment because we have had the fall-off in GST compared to what we were expecting. The growth in GST is only half or less than half of what it was only three years ago. It has become a much more critical debate now.

Mr WILKINSON - Is there also a debate in relation to those that are in the public system that are, and should be, in the private system but want to be dealt with in the public system but should be dealt with in the private system? I accept that a number of operations or procedures can only be done in the public system because of, say, emergency et cetera, but there must still be a significant number of people in the public system who can fall back on their private insurance.

Mr WALLACE - The factors that give rise to what we have are quite complex and the national policy, which all of the States have agreed to, is effectively dictating it so there is very little flexibility for individual States to go down different routes in this. I am not an expert on health; it has been a number of years since I've worked in the department so

I am probably not the best person to answer this question. Presumably that sort of debate is happening at a national level between the Commonwealth and State Health departments.

Mr WILKINSON - Have there been any figures done on that at all?

Mr WALLACE - Treasury wouldn't have those figures.

Mr WILKINSON - But you believe Health would?

Mr WALLACE - Several years ago they would have, but whether they may have figures still available, I am not quite sure.

CHAIR - To go back to an area that was debated in our House a couple of weeks ago - the Tasmanian health organisations - the Commonwealth are effectively imposing that change, the local hospital network arrangement and the activity-based funding model for service delivery in our hospitals. Did you do modelling on the different costs of one versus three THOs?

Mr WALLACE - I think Treasury did and we had a lot of discussion with Health and Human Services about the cost differentials.

CHAIR - So what sort of advice did you give them?

Mr WALLACE - It wasn't for us to give advice. They would be involved in recommending to the Government within the constraints the Commonwealth imposed, which are really significant in this regard. They would be responsible for the advice to the Government but consulted with Treasury in relation to that. The Commonwealth requirements were fairly strict about the number and nature of local health networks. Of course the world has changed a lot in the last 12 months so whether the Commonwealth would have the same views, I am not quite sure. I can't quite remember the process by which the State ended up with the three-region model.

CHAIR - Did the department ask Treasury at all to look at the cost of one versus three or two?

Mr WALLACE - That would be a departmental responsibility. They are the only ones who can measure the costs of one versus three, because it is not just the cost of the three boards and three organisations. It is about how you effectively deliver services to each region, what services are provided and procured centrally versus what services are procured and provided from the region, and the way in which central services are provided to the region or through the regional health boards. All of those things impact on the cost of a three THO model compared to a one THO model. Most of the costs are around the service delivery model, not the fact that you have three boards.

CHAIR - So the Department of Health didn't ask for any Treasury involvement in the determination of the costs associated with it?

Mr WALLACE - What happens with these things is that, when they go to Cabinet, Premier and Cabinet and Treasury provide comment on Cabinet's submission. It is always the

case that we provide advice on things that have financial consequences. From my recollection there was a consultation the Department of Health had with the other relevant agencies, Premier and Cabinet and us, about the cost and benefits of the Commonwealth constraints around how many LHNs we could have and what they would look like. I just can't remember the details but I do remember being involved in some discussions about it several months ago.

CHAIR - Cabinet considered one and also considered three, then you would have provided some input into that, as DPAC also would have. Are you able to provide that -

Mr FERRALL - We provided commentary on the cabinet submission and the department provided commentary to Cabinet, consistent with our role in any departmental Cabinet submission that goes forward.

CHAIR - Which includes some financial consideration.

Mr FERRALL - It would include commentary on the financial details that were disclosed in the cabinet submission.

Mr WALLACE - As we always have to because we don't have the resources necessary to do anything else, we rely on the information that comes from the agency. We are not there to second-guess the agency so we rely on the information that comes from the agency or, if it is a government business issue, from the business. We provide comment on the basis of what we can see in terms of the facts that have been presented.

CHAIR - Are you able to provide copies to the committee?

Mr WALLACE - If it's advice to Cabinet then we would need to take that question back and, if we are able to provide it, it would have to be provided in camera.

CHAIR - Yes, I appreciate that.

Mr HALL - While we are talking about Commonwealth-State relationships, no doubt you would have seen the media release from the AMA this morning which talked about the Wilkie deal?

Mr WALLACE - No, I haven't seen it.

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Mr HALL - Does it concern you that the GST money may not flow through to the State and, therefore, have implications, particularly on the whole State Budget -

Mr WALLACE - Is this about the funding from the Commonwealth for the hospital and how it is getting treated in the fiscal equalisation process?

Mr HALL - Yes.

Mr WALLACE - I suppose it is a bit of a surprise to us that it is a surprise to anybody that this is what has happened because by its very nature, fiscal equalisation is about equalising the fiscal capacities of the States; that is a long standing principle. Before GST, it was financial assistance grants that the Commonwealth made available. They

were a substantial proportion of the State revenue like GST grants that replace them now. They get distributed on a fiscal equalisation basis so if any State gets a special deal in relation to Commonwealth funding for a State core service, a State-type service such as health, then federally that benefit gets redistributed to the other States. That is what fiscal equalisation is all about. The system has always been like that so it does, I suppose, prevent or work against people getting special deals, no matter which State it is. If you get a special deal up basically you are bound to lose the value of it.

My comments relate to State services; they don't relate to things that the Grants Commission doesn't take into account because they don't see them as State services. There have been examples raised; for example, how come the forestry intergovernmental agreement was quarantined? Well, there was hardly any element of State service in that. That's about economic compensation; that's not about services such as health.

My comments relate to health, so, yes, in this case it is a concern for us because it is such a large amount of money. It has a potential impact and it has been quoted as $90-odd million a year for three years, but we won't know the impact of it or start to be able to understand the full impact of it, until the Grants Commission relativity update comes out in February and there will be a mixture of things that impact on the States relativity, and which determine the GST distribution and this will be one of them, but there are a range of other factors that are happening. The revenue capacity of Western Australia is increasing significantly compared to Tasmania and we hope we get some benefit from that. If we lose some money as the result of the Royal Hobart Hospital deal, we hope the other things that work in our favour will offset that so our relativity doesn't fall. We don't know what the outcome will be, but it has always been part and parcel of fiscal equalisation.

Mr HALL - Interesting times.

Mr HARRISS - The nub of that then is that on the Royal Hobart Hospital deal, we have been dudded.

Mr WALLACE - No.

Mr WILKINSON - The jury is out, isn't it?

Mr WALLACE - All I am saying is that if you get a special deal of Commonwealth funding -

Mr HARRISS - Then only the Prime Minister knows the details of it.

Mr WALLACE - it will basically be redistributed by the Grants Commission to all States so that all States are treated equally.

CHAIR - Unless it is excluded. If Wilkie had thought he was going to get a real deal he would have had it excluded.

Mr WALLACE - Well getting funding for core State services excluded is not something that is very easy. Obviously, otherwise it compromises the whole process, particularly from

Tasmania's perspective. Why would we want to compromise the process that is fundamental to our whole budget and our sustainability of services.

CHAIR - It could change anyway, couldn't it, very soon.

Mr WALLACE - Well, yes, but I hope not.

CHAIR - The reality is that it could.

Dr GOODWIN - Before we go off that, were the consequences of that decision made clear to the relevant parties? Would the Premier have been aware of the consequences?

Mr WALLACE - I wasn't here at the time, so I don't know. But it has been a fundamental feature of the arrangements for a long time. I think this particular approach by the Grants Commission, the inclusion approach, has been in place since at least the 1980s. I would think that most people and politicians would understand it. I don't know how the deal was done and I don't know to what extent advice was sought or given in relation to the deal.

Dr GOODWIN - I suppose the point is that potentially the State loses the flexibility to decide where to allocate the funding. That is the whole issue; if we end up losing out -

CHAIR - It appears on the bottom line that we don't get a benefit from it, except for a new Royal Hobart Hospital - eventually.

Dr GOODWIN - Yes. But then we have people coming into the hospital at the moment, seeing the impact of the cuts and asking why we are going down that path.

Mr WALLACE - I think it is a difficult one. If the Commonwealth funding, whether it's for the hospital or something else, is in line with your own priorities you would have spent that money anyway. Effectively, you are just getting it through a different source. Instead of getting it from GST, you are getting it through a specific purpose payment. You always have to be mindful of the magnitude of it and particularly, as we look forward, the next three years is a bad time for this effect to be happening.

CHAIR - It leaves no flexibility to try to ease the pressures on the patients.

Mr WALLACE - There's nothing we can do about it.

CHAIR - No.

Mr WALLACE - The Grants Commission will treat it this way, according to the Grants Commission methodology in their latest review, which I think was 2010.

CHAIR - Just going back to the savings target or requirements in the Health department, I am not sure whether you have specifically answered this but I'll ask the question anyway. How was the figure of $100 million savings target actually arrived at in Health? How did you get to that particular figure? It seems to be an absolutely nice round figure.

Mr WALLACE - I think I explained the basic way in which the calculation was done. I haven't really got anything that shows line by line how the number comes out but it's essentially the same methodology I described before.

Mr FERRALL - I don't think it gives the line by line to get to the $100.2 million. Suffice to say, during the budget process in terms of identifying broad savings targets, we didn't simply target a single number. We effectively had a range so ultimately the $100.2 million was what Cabinet decided was the appropriate figure within that range, so -

CHAIR - Did Treasury provide advice to Cabinet across a range of figures between *x* and *y* where $100 million was somewhere between?

Mr FERRALL - When each of the departments came, going through the budget process, and identified the sorts of actions they might have to take to achieve their particular budget task, some of those tasks for some departments were adjusted because there are considerations that some of the actions that we were going to take would be too difficult or unpalatable, et cetera. It was through that process that, when you got to the final level for each individual department, there were a series of cabinet decisions which moved them up and down slightly.

CHAIR - So you are saying that the Government basically provide the advice to Treasury - I am just trying to get my head around -

Mr FERRALL - Treasury gave the Government a range of options which, again, is not unusual in the budget process. We don't provide only one solution; we provide a range of options. Cabinet takes that into account and considers a whole range of other issues, even advice from other departments, to come up with a position and say, 'Okay, this is how we want to disaggregate the task across each of the departments.'

CHAIR - So, the Government came to Treasury and said this is what we need you to achieve; you tell us how. Is that -

Mr WALLACE - No. Basically, we identify right at the beginning. We provide advice to the Government on the sustainability of its finances, particularly the ability to sustainably fund core services into the future. Out of that sort of process come decisions about how long we have to pull this budget into a sustainable position. Out of that come rough calculations of the size of the savings we need to achieve in each year. We provide advice to the Government and to the Treasurer about ways in which to allocate this task or to achieve these savings. They decide which way to do it and then, given that, we work with the agencies to support the process where information then goes back to budget committee to make final decisions about how the budget is going to be delivered. So, Treasury basically provides advice, and on the basis of that the Treasurer, the budget committee and Cabinet make the decisions that we then implement working with agencies.

So that's effectively how it works. In the case of how the numbers are calculated for each agency, we suggest it as an option but particularly an option to try to make it as equitable as possible. You could allocate the budget task to agencies on various bases so we came up with a methodology which was refined and discussed, including with other

agencies during the budget process, and ended up with these numbers. But the basic premise was that we allocated the task according to the relative size of each agency's Consolidated Fund allocation, less its administered payments, and then we made some adjustments for some specific agencies because they hadn't fully delivered the savings from previous years.

CHAIR - On that point, Health seems to be getting a fairly large section of this. It is a big department and I accept it's got the biggest budget of any department. Obviously you would expect the figure to be higher but when you look at it percentage wise, this is a service deliverer that is core business of the State. You could look at, say, other areas like DPAC where you are not really delivering a service. You have a lot of ministerial advisers and staff. You have a minister for renewable energy and a minister for energy; you have a minister for infrastructure, a minister for sustainable transport - with all the additional staff that flow around them. Was that looked at, trying to streamline those other areas and other departments so that Health wouldn't need to take such a big hit?

Mr WALLACE - Well, administered payments are things that agencies can't control so they need to be taken out of the calculation. Once you take them out of the calculation, Health is 46 or 47 per cent of the budget. So, whichever way you look at it, they are going to have a sizable chunk of the savings that are needed.

CHAIR - Yes, but that's not answering the question. When you look at Health being a service deliverer, a lot of departments such as Treasury and Finance and DPAC, and different ministers with different staff, are not service deliverers.

Mr WALLACE - We did a calculation in the way I've described and we ended up with a number for each agency. These were like indicative numbers and then agencies went away and identified how they could meet that task and what the implications were. Then that went back to budget committee and Cabinet and that committee made decisions about areas they would accept or strategies they would not accept. So they're not things Treasury decide. I can tell you how the calculation is done, but the end decisions are decisions by the Government.

CHAIR - Does every department have a budget control or business control team?

Mr WALLACE - No. Because of the complexity of Health and how -

CHAIR - Only Health?

Mr FERRALL - Only Health and that was put in place at the request of the secretary of the department. It was an arrangement where obviously the previous secretary had resigned and there was an acting secretary and at the time she was looking for greater support in terms of trying to deal with some of the complexities that she was attempting to manage.

CHAIR - Before the decision was made with the $100 million savings for this year and the $150 million or whatever it was for the forward Estimates, were there discussions before that with the department and Treasury, talking about the task ahead before the decision was made as to the actual figure?

Mr FERRALL - Through the budget development process there are a series of meetings with Treasury and there are a series of meetings with budget subcommittee. I'd have to check but I think Health came to budget subcommittees three times.

Mr WALLACE - Yes, I think it was three times.

Mr FERRALL - During the budget development process.

Mr WALLACE - Yes, before the budget was finalised.

Mr FERRALL - They come to budget committee, they present and there's discussion around a range of issues they're dealing with. Prior to budget committee making a recommendation to Cabinet in respect of the final budget allocations and savings tasks there would have been a range of meetings with Treasury and the budget committee.

CHAIR - When the Health department came to the budget review committee at that time, what were they saying? Were they saying they couldn't afford to cut that much or did they have an idea of how much they could cut without impacting on direct patient care?

Mr FERRALL - It's hard to say exactly what they were saying at any particular meeting but what they were flagging was they hadn't identified specific strategies for the full level of savings but they were indicating that it was a level of savings they believed would be achievable.

Mr WALLACE - Yes. Given the period of time over which they were being developed, my recollection is they were looking at general metrics about how efficient they were compared to other States and those sorts of things, and the impact of the Commonwealth reforms, in saying we should be able to achieve or need to achieve these savings over a period of time. As Tony said, the specific strategies weren't identified at that point but there was general agreement that savings of this sort of magnitude should be able to be delivered over this period of time and we need to get there anyway because the Commonwealth will start funding us only for the efficient costs of providing services.

CHAIR - This is where I find it very difficult. Health officials were saying that they could effect those levels of savings but still meet the Commonwealth requirements on activity-based funding and the incentive payments that the Commonwealth were promising if you met certain targets, but by cutting frontline services there's no way you can meet those efficiency targets that the Commonwealth are going to pay in efficiency dividends or funds for. Doesn't that ring a bell?

Mr WALLACE - Those specific strategies were identified later by the department.

CHAIR - The cutting of elective surgery and so on?

Mr WALLACE - Yes. The initial conversation was about what does our cost base need to look like in several years time, particularly with national health reform. Looking at how our efficiency compared with other States and their delivery services there was a general view that these savings were deliverable and were appropriate. Then when the detail was worked out and the department identified these particular strategies, that is what they

identified as being necessary to deliver these, in particular, first-year targets. That's as far as I can answer the question because it's really the department you should be asking.

Mr WILKINSON - How did our efficiency rank with other hospitals or other health services around the country?

Mr WALLACE - There are various measures. The Grants Commission does a measure, for example, after they've taken into account cost disabilities and differential demand factors. They give you a weighting for your needs and they compare assessed expenditure, which is taking into account your needs, with average expenditure. For admitted patients, probably the most relevant one here, we are something like $70 million per annum higher than what the Grants Commission assesses we need to spend. Don't quote me on that number but it's something like that.

Mr WILKINSON - Can we have that figure?

Mr WALLACE - It's in the Grants Commission report. Then there are a range of other measures. All these measures have issues and caveats around them, so there is a Grants Commission measure and there are other measures like the Health and Welfare Institute and those sorts of things. The review of government service provision report each year identifies efficiency differences between the States. Generally speaking, our system costs more for a lower level of output than the other States. The extent to which that's intrinsic or unavoidable because of our cost disabilities versus just being inefficient is -

CHAIR - It doesn't measure that specifically, though, does it?

Mr WALLACE - No. That's the dilemma. So we won't know the exact number until the Commonwealth puts in the efficient benchmarks. Then we'll know exactly what the difference is.

Dr GOODWIN - I want to ask about the savings that Health hadn't managed to achieve previously, which resulted in their having a greater share of the savings to fund this time. Are you able to elaborate on what the savings were or what value was put on that?

Mr FERRALL - It was approximately $32 million. I explained earlier that there were a whole range of adjustments made to their budget leading up to the 2011-12 Budget. When we say they had a savings target of $100.2 million, that was after a whole range of additions that were added to their budget. One of the additions that was added to their budget was effectively the savings that they hadn't been able to deliver previously. We had added back an adjustment which was for those previously undelivered savings. If you go back through the prior savings, you mentioned earlier the previous Treasurer, and you will also recall that previous Premier effectively made some decisions around quarantining frontline services from the earlier saving strategies. It was through that process that additional funding had been added to the department's budget as well, over and above their initial saving strategies.

CHAIR - So what they're saying about it being more than $100 million, again, you would dispute because they'd already had the budget basically boosted a bit to cover -

Mr FERRALL - It's $100.2 million. It's always difficult with these questions of what are the savings because it depends what they are compared to.

CHAIR - That's right.

Mr FERRALL - Do you compare it to the forward Estimate in 2008-09, as it was then, or do you compare it to the forward Estimate in the 2010-11 Budget -

CHAIR - Or the actual.

Mr FERRALL - Or the actual in 2010-11 which might have a whole range of one-off factors which you need to adjust out. So, I guess you can get a range of legitimate figures in terms of what the $100.2 million might mean as a percentage or as a comparison but if you are doing any analysis of that you really need to look at the components so you can understand fully. If you are doing the actuals, what was the actual outcome in 2010-11, what were the factors that contributed to that outcome which might be a range of one-off issues? A good example in 2010-11 would be that there was additional funding provided to housing in relation to the economic stimulus plan. That would show in the actuals in 2010-11 for the department on a whole-of-department basis. You would need to know that or understand that if you are going to make any comparison to the budget versus the actuals or to the current year's budget.

CHAIR - We might just have a break for a few minutes to have a cup of tea if you like and then we'll come back to that point.

Short suspension.

CHAIR - Jim, I believe you were about to pose a question.

Mr WILKINSON - It's a question without notice now.

Laughter.

Mr WILKINSON - The question was, Tony, when you were speaking about what we compare with - that is the $100.2 million in relation to savings - to see whether health has been consistent with the $100 million saving strategy?

Mr FERRALL - It's probably a question that is quite difficult to answer. At the end of the day, from a Treasury perspective, the most important thing is that they come in on budget and manage to their budget allocation. We have a process of managing or monitoring their savings strategies through the year and they have a process internally which, to date, is indicating that many or most of their strategies are on target. We can form an assumption, based on the fact that most of their strategies are on target, that they are more than likely going to come in on budget or close to budget. However, there is a whole range of other variables which might occur and might ultimately lead them to not be on budget. So you could have a sort of strange scenario where they deliver the $100.2 million of savings strategies through each of the identified strategies but something else happens internally in terms of their budget management such as some other form of cost pressure or some other form of issue which leads them to potentially go over budget. You could have the other side of it which is that they deliver on the

$100.2 million and create some issues or service delivery and a whole range of things that need to be managed but then other parts within their budget go better and they might actually come in under budget.

CHAIR - That would make Treasury smile, wouldn't it?

Laughter.

Mr FERRALL - I could say that it would bring a smile, but I think it's quite unlikely, given the history. So when you say what do you compare the $100.2 million to, it's really saying it can give us a good indication. If they are finding strategies that are equivalent to the $100.2 million and are managing those strategies through the year to deliver that level of saving, it gives us a good indication that they are more than likely to come in on budget. If they're not delivering on those strategies, I think we can be reasonably or very confident that they won't be able to deliver their budget at the end of the year.

If you want to compare it to something, do you compare it to their actual expenditure last year, do you compare it to their budget last year or do you compare it to their budget this year? You could compare it to a whole lot of different things and you could come up with a different percentage. Do you compare it to the recurrent budget, do you disaggregate the $100.2 million and compare the hospital component to the hospital component in their budget because there are other components including housing where there are other saving strategies?

CHAIR - It would be good to do that at least - to do the acute health services and even primary health services for that matter, but particularly acute health services, which is where the cuts are particularly hitting at the moment to look at what their savings are related to their actuals of last year, the budget of last year and this year's budget where it's tracking.

Mr FERRALL - Health would need to do that at that level because -

CHAIR - So health would need to provide that?

Mr FERRALL - Yes, again, without trying to make it difficult, we don't have proper indications of how they might apply overheads across those areas; you are starting to get into a level of detail for which you need to use the internal budget of department to do that formal analysis. But it is doable.

Mr WILKINSON - How are you going to compare it because, let's say, at the end of the year they'll be saying to Treasury, 'Look, we believe we have achieved our budget,' and you're going to say, 'Okay, show me how you've achieved the budget and the savings of $100.2 million.'

Mr FERRALL - Well, we'll know when they've achieved their budget. As at 30 June or a few days after we will know; we can measure it in a global sense. We won't have, at that point, the disaggregation and you might see that the acute area is over but there might be savings in other areas which offset it; from a Treasury perspective we'd say okay, the department has managed to budget and that's a good outcome.

Mr WILKINSON - Managed to budget and managed to make this $100.2 million savings; would you be able to say that by looking at their budget?

Mr FERRALL - Well, we'll be able to say they've made the $100.2 million because they will have come in on budget.

Mr WILKINSON - Okay.

CHAIR - The budget includes that saving. On that point of unexpected or perhaps costs or additional funding might come in from the Commonwealth - probably unlikely at the moment - has the $50 million pay rise for nurses over three years been factored in to their budget for this year?

Mr FERRALL - Yes, the existing wages agreement is factored into the budget in forward Estimates. The 2 per cent wages policy is for new agreements, and existing agreements were funded within the budget, so it's only as an existent agreement rolls off or ceases that the Government policy is to move to 2 per cent.

CHAIR - It is only 2 per cent anyway this year for the nurses.

Mr FERRALL - Yes, but what was factored into the budget was all of the known increases from the previous wage increase.

CHAIR - When is the next wage agreement for the nurses? It's 2 per cent for the next three years. That's what was said in the media but maybe that's not right.

Mr WALLACE - The Government announced that it's wages policy was 2 per cent per annum.

Mr FERRALL - The nurses agreement comes up in calendar year 2012 but I'm not sure of the exact date.

CHAIR - It's being capped at 2 per cent?

Mr FERRALL - That's the wages policy.

Dr GOODWIN - There are some quite significant concerns about the impact of the cuts that are going to directly affect patient care, particularly the elective surgery cuts. One of the concerns is that you might save some money now but it could result in further costs in the medium to long term because people end up presenting to the emergency department and those sorts of issues. Has Treasury given any consideration to that and also how you measure that impact?

Mr WALLACE - Treasury can't be experts in everything and we're certainly not. We're certainly not experts on the best way of delivering health care in the future so we have to rely on the agency to identify strategies that they believe are sustainable. They've identified this particular strategy so there may be impacts of it that we are not aware of which may add future costs or save future costs some time in the future. We are just not in a position to answer that question. Because our main focus is having a sustainable State budget position so we can have sustainable service delivery, obviously if these are

the impacts - and I'm not saying thy are - then that's obviously a concern because we have to then have further strategies in the future to address the cost increases that have occurred on top of these. The agencies fully understand this, so in identifying these things they must have given consideration to that.

Dr GOODWIN - So there isn't any flexibility for them to say, look, these last $30 million of cuts are going to impact directly on patient care, so could we perhaps defer that extra $30 million and have a bit more time to try and find savings elsewhere. There isn't or wasn't that sort of capacity?

Mr WALLACE - It's very difficult when you are well into a financial year to provide that sort of capacity. For reasons we discussed earlier, all of those specific strategies hadn't been identified at the time the Budget had been agreed and delivered.

Mr WILKINSON - What discussions need to be had for containing costs, because we hear that there is some medical equipment within the State, when you look at per head of population, far in excess of what there is in other States. That machinery costs millions of dollars. Does Health speak with Treasury at all in relation to that or is that strictly a Health decision; they've got *x* amount of money and they decide to purchase equipment without speaking with Treasury?

Mr FERRALL - It does depend on the nature of the decision and potentially the capital cost. As an example, if a particular piece of equipment was going to be a small dollar cost that effectively or potentially could be managed by the department through its own existing budget allocation, there'd be unlikely to be any major discussion with Treasury in that case. If it's a major capital purchase then it's likely to be funded by a separate allocation in which case there would be a discussion; it could be that it goes through the structured infrastructure investment review process which is detailed in the budget papers. That would involve a whole series of discussions and a whole series of information being provided to the Government in terms of that particular decision. So it depends but I guess your point is that there are sometimes capital purchases which impose ongoing additional costs which need to be managed.

CHAIR - Operational costs as well as maintenance.

Mr FERRALL - Operational costs. The department with a small purchase would take those into account and manage those. With a more significant capital purchase we, together with the department, would be likely to put some advice to the Government on the potential impact of those.

Mr WILKINSON - That's now.

Mr FERRALL - Well, it would have been in the past as well.

Mr WILKINSON - But then it's still a government decision whether to purchase it or not.

Mr FERRALL - In some cases it's not necessarily even a government decision because sometimes you get gifts from the Commonwealth which have ongoing trailing costs for the State.

CHAIR - They provide a capital expenditure fund and you provide the recurrent.

Mr FERRALL - Yes.

Mr WALLACE - Offers you can't effectively refuse.

CHAIR - That's right; but they tie you to an ongoing recurrent funding commitment.

Mr WALLACE - Yes.

Mr WILKINSON - But is it true to say that in relation to some of these machines which cost a significant amount of money firstly to purchase and secondly to upkeep and operate, we have an abundance of them for the population that we have; there is a linear accelerator, for example.

Mr FERRALL - There's no doubt that Tasmania has a small population and in some cases, has greater access to some of this machinery than you would see on a per capita basis in other States and other jurisdictions. There is no doubt that is the case. They are difficult decisions to manage in terms of both acquiring and continuing those services on an ongoing basis. You are addressing questions of what you do with our relatively dispersed population, the difficulties of communities getting access to some of this equipment. Access arrangements in Tasmania are quite different to those in a major population centre such as Melbourne where you might have a greater number of members of the community per linear accelerator but their access to that equipment might be much easier than in our Tasmanian context. You have to sort of balance those things up but we do in some areas have a greater level of capital equipment than you might see in other jurisdictions.

Mr WILKINSON - I understand that in Launceston there might be three linear accelerators. Am I right in saying that?

CHAIR - Yes.

Mr WILKINSON - Whereas, I understand in Victoria there are probably two for the whole of that State. Am I right in saying that?

Mr WALLACE - I think it would be a lot more in Victoria but there is certainly a huge number -

Mr WILKINSON - Two per million or something.

Mr WALLACE - There are certainly huge economies of scale. I don't know what the situation is at the LGH but the distribution of our population and the fact that we run four major hospitals and we are trying to do the same sort of stuff at every hospital will inevitably lead to less efficient usage of these sorts of equipment than what is economically desirable. The fact that the Commonwealth has a role now in relation to the Mersey does cut off the options the State has anyway, in relation to these costs.

Mr WILKINSON - But, that's probably a debate to be had, is it not? I think that's something to be looking at as well. If we want to do the job as best we can, we can't spread the butter too thinly. We probably are; that's my view but I want to ask your view.

CHAIR - With regard to the national health reforms started under former Prime Minister Rudd with the threat to take over everyone that didn't pull their socks up, obviously we know what happened to him and then we've got a changed national health reform agenda. As far as the discussions went in Tasmania about managing this, we have talked about it with the Tasmanian health organisations and the local hospital networks, and about the activity-based funding, was Treasury involved at all or were Treasury staff allocated to meetings went on for months around this with health. Was there any Treasury official allocated to that process at all?

Mr WALLACE - Yes. I think Health and Human Services, Premier and Cabinet and Treasury put significant resources over a long period of time in negotiations. The Commonwealth set up a process which had significant intensive work by various groups. Treasury has a responsibility in terms of policy advice and Commonwealth State financial relations and a lot of those reforms impacted on the existing system and the structure of Commonwealth-State financial relations. They were inextricably linked to the policy issues that Health and DPAC had to deal with, so the three agencies worked very closely over a long period of time with significant resources poured into the ever-changing landscape of what we call national health reform. Now we have an implementation challenge which is to have things in place by 1 July.

CHAIR - When you say over a very long period of time, when did those discussions start?

Mr WALLACE - I don't know; I have only been in the job 12 months but it was certainly well before that. They had the previous model proposed by the previous prime minister; that's effectively when it started and then it sort of morphed over time.

CHAIR - That was with the clawback of GST to fund it.

Mr WALLACE - That's right.

CHAIR - That was thrown out, effectively.

Mr WALLACE - Yes. Notwithstanding that the funding arrangement changed, Treasury still had a significant involvement in working through a range of issues, as did all State treasuries. So basically there was the heads of treasuries - HOTs; the deputies group, what is called the deputy-HOTs and it oversaw a significant body of work related to the health reforms; the senior officials group where Premier and Cabinet and Prime Minister and Cabinet were part of all that; and the premier and cabinet of every State. They oversaw aspects and then you had Health and Human Services and the equivalents in other States that were involved in the detail, so there has been a large amount of work for a lot of people. Now where we have ended up is something that most States and the Commonwealth have agreed on, but there is a lot of work to be done to put it in place and make it work effectively.

CHAIR - I'm not sure exactly when the revised funding model was agreed to, but after the clawback of the GST was basically rejected and we went into the 60:40 split as opposed to 40:60. That would only be the last couple of years, wouldn't it?

Mr WALLACE - Oh, yes, some time in the last 12 months.

CHAIR - Can you provide us with the minutes of those meetings that went on where Treasury was involved?

Mr WALLACE - They are national meetings so I would have to check whether we can provide them. These are national approaches by the States working with the Commonwealth.

CHAIR - When the State was working on how it would comply with the requirements that the Federal Government was imposing - and they are imposing changes -

Mr WALLACE - The Department of Premier and Cabinet coordinated that process.

CHAIR - Did Treasury have representatives on that process?

Mr WALLACE - We were involved in certain aspects of it, yes. I'm not across all the detail; I just know that there were lots of meetings.

Mr FERRALL - There were various components to this. By way of example, the legislative changes that were necessary were led by the Department of Health and Human Services but I had people from three of my areas effectively working with them and involved. We had people from our general accounting area involved, we had people from budget area and we had people from the shareholder policy and markets branch involved so there was quite a lot of involvement right through Treasury on different aspects. If you looked at the high level of potentially the funding model and the funding flows, again, I have had people from the Government Finance and Accounting Branch involved in that. We've also had people from the budget branch involved. So there are different aspects to the reform that we've had different experts involved.

Mr WALLACE - Thousands of meetings happened at both national level and internally. On both sides of Treasury there has been a significant amount of work. The intergovernmental financial policy branch would have been working with the other State treasuries and the Commonwealth about the details around this. There is a huge amount of detail about how this actually is made to work in practice. In getting the minutes of the meetings, we don't control all those but we can look at what's there.

CHAIR - I think it would be helpful for the committee to understand a bit about how the decisions around the Tasmanian arrangements that we are going to implementing in July were arrived at.

Mr WALLACE - Okay.

CHAIR - If Treasury had some involvement in that then -

Mr WALLACE - We didn't lead that -

CHAIR - No, I know you didn't lead it, I accept that, but there would have been people on the ground at those meetings.

When we get to the end of the financial year, as you said, you'll know whether the department has come in on budget. You accept there is a risk that perhaps they won't; past history being one indicator but also the fact they've identified $8 million as a risk anyway. What is the plan for reviewing where to go from there regarding forward Estimates and expectations because one would expect that if you can't make the required savings this year that will have implications for subsequent years as far as the bigger budget picture goes.

Mr WALLACE - The general point is that we will review and be publishing in these quarterly reports how agencies are tracking against their budget. At the same time, over the top of that, the financial circumstances may change, like we found in the Commonwealth MYEFO report about the GST revenue reducing significantly but not substantially, and there is going to be the Grants Commission report in February. All of these things are going to go into the mix of the budget consideration. The question you pose is hypothetical for us at this stage. What actually happens out of all this is impossible to answer but, as I said at the beginning, if this is a timing issue in relation to not all of the savings being delivered by 30 June but delivered in July or August then it's a different proposition but it doesn't change the strategy. It just means that the strategy has to be caught up to hit where the Government wants to be in the targets by the end of the forward Estimate period to be in a sustainable financial position. It really depends on the nature of the problem and the extent of it, if there is one, and we won't know that until we go further through the year.

CHAIR - Health has a business control team to monitor that more closely than any other department?

Mr WALLACE - Yes.

CHAIR - Is Treasury taking the same attention to detail with other departments in expectation that they will also come in under their budget?

Mr WALLACE - Yes.

Mr FERRALL - There are meetings with all departments. In fact, all departments are meeting regularly with budget committee as well in terms of through-the-year monitoring. For example, Treasury has to provide other parts of Treasury with reports how it's travelling on its budget. Martin had to attend budget committee in August or September or thereabouts to detail how he, as a head of agency, was implementing Treasury's budget management strategies internally and provide budget committee with his assessment as to how we were travelling and his view as to how things would be at the end of the year. All heads of agency went through that same process. That is in addition to the normal liaison meetings that we have.

CHAIR - When is the next quarter report due out?

Mr FERRALL - The midyear financial report in February. It has to be published by 15 February.

Mr WALLACE - That will collect a whole range of information, not just the agencies' saving strategies.

CHAIR - So you won't see the budget saving strategy updated; it will all be included in the midyear financial report.

Mr WILKINSON - Years ago when Tony Rundle was premier, New Brunswick was held up as the State to look at; remember that? Then when David Crean came in as Treasurer, Martin I think was his right-hand man. Then it was Ireland -

Mr WALLACE - And Oregon.

Mr WILKINSON - In relation to health, and in relation to a state or jurisdiction that has found itself in difficulties but has got out of difficulties through prudent management, ensuring it still give the services that are required and expected, is there any state or territory or jurisdiction that one should look at or get information from that Tasmania should look at to see how they've done it and that might be a fair model to follow?

Mr FERRALL - I think you have got to put it in the context of the GFC. There would be probably no jurisdiction around the world that hasn't had some impact from the GFC. The reality is that the context of those jurisdictions has changed quite significantly. If you look at the published reports from the UK, there have been huge shifts over there. If you look at the US, they are still running at 8-9 per cent unemployment and still have major issues in terms of delivery of health services and other services throughout the country. I can't speak with total authority but I think you'd be lucky to find a jurisdiction that is fairing as well as Australia overall.

Mr WILKINSON - And which State in Australia?

Mr WALLACE - It's a really interesting question and I'd like to be able to give you a really good answer to it but the dilemma is that, yes, State governments, over the period of time I've been involved within and outside the public sector, have looked at various models and for a period of time those models seem to have worked very effectively, so they've tried to put them in place in their own State only to find that they failed because the circumstances were different. The population, the characteristics or the culture or whatever it was, there always seemed to be some reason. They tidied up the National Health System in the UK and away it went and everything was great but now, of course, everyone is discovering all these problems which seem to have popped up as a result of the approach they take. So I'd like to give you a more definitive answer. There is a lot to learn from looking elsewhere but you have to be careful about making judgments about whether it would work in Tasmania because we are fairly unique in the Australian context. Is there now any jurisdiction we could point to and say, yes, we should follow them? I don't think so. They've all got their problems at the moment but to different degrees. The lesson is, yes, there's a lot to be learned; we can't do this on our own, the problems are very challenging. Other places in the world have used various strategies; some have worked and some haven't. We have got to learn from that. That doesn't really answer your question.

Mr WILKINSON - So there is no real model of which you can say that's the one we should get some assistance from?

Mr WALLACE - I'm probably not close enough to it at the present time but from what I can see all the States have major issues.

Mr FERRALL - All the States have their various issues.

CHAIR - We just led the charge?

Mr FERRALL - South Australia were about the same time.

Mr WALLACE - And the same order of magnitude, from my recollection.

Mr FERRALL - Victoria are starting to show issues whereas for a period they were looking like they might have a model that, they claimed, should be replicated.

Dr GOODWIN - I would have thought that Treasury would be in a really good position from a whole-of-government perspective to know where there are potential savings to be made or efficiencies or things - units, whatever - that have been added over the years that perhaps could be taken away without too much of an impact. Have you been doing much work in that space? How proactive has Treasury been in terms of identifying savings besides what you have been asking the agencies to do?

Mr FERRALL - Certainly as part of the budget process we provided advice, including advice to budget committee of Cabinet, of all the policy decisions and changes that have occurred in recent years. Effectively you can collect that up through the budget papers by basically saying, well, what are some of the shifts and changes and new things that have been announced et cetera. We put those to Cabinet so that Cabinet could actually reconsider whether those things were still a priority in light of where things are at. You did see, as part of the midyear report last December and the Budget, a range of areas where the Government changed its priorities. So it previously had announced election and other commitments but it said, no, we have decided to move away from those priorities. That essentially came about through a process of us providing advice on a whole range of areas.

When you start to talk about the detail within agencies of where there might be efficiencies or otherwise, it gets much more difficult. We can and do provide benchmarking in different areas but at best they can only be used as indicators. For some of the reasons we spoke about earlier you can't immediately jump to a conclusion that we are more or less efficient than another jurisdiction because of those indicators, but they certainly lead you to ask questions. That occurs right through the budget process and occurs right through the year.

We also use things like the Auditor-General's reports, which quite often indicate anomalies or perceived anomalies across departments. There is a range of areas we look at but there isn't any sort of magic bullet that will say, 'Look we just found $100 million'.

Dr GOODWIN - When you went back and had a look at what's been added, how far back did you go?

Mr FERRALL - I'd have to check but I think we probably went back about four years.

Dr GOODWIN - Do you have any plans to go back further than that to have a further look?

Mr FERRALL - Not immediately.

Mr WALLACE - We don't have an army of people in Treasury; we're actually a lot smaller than people think. All these things would be great to do and you could do a lot of work but at the end of the day the model will largely depend on the information that agencies and government businesses give us and we use that as the basis for our analysis. There are so many things happen on a daily basis in these organisations that you can't possibly keep track of it all. We pick up stuff in a central process, like specific decisions which add a function. Even that becomes a very complicated calculation very quickly

Dr GOODWIN - Ultimately it's a cabinet decision.

Mr WALLACE - That's right.

Dr GOODWIN - I suppose you just recommend the things that you think might be -

Mr FERRALL - Over many years we have provided advice in terms of things like relative size of corporate services across agencies, details in terms of relative classification within agencies, whether there is any reason why *x* agency has this sort of profile whereas this one has another. At best, all it can be is a set of indicators that then the Government needs to consider in light of its policy priorities and where it wants to finally make decisions. You can't take any of those things in isolation and say, well that means *x* and therefore you can make this decision.

There are lots of indicators like that which we work on periodically, depending on where a particular budget cycle is and what we might put forward to Cabinet. Sometimes these things happen every few years and you think it's probably worthwhile looking at that again. We looked at that a few years ago but the same things are happening so let's put forward some analysis on that.

Just on the FTEs, I know the September quarterly report did give a breakdown of the FTEs going back to June 2010 and September 2011. In the December report I anticipate it will go to the next year or next quarter. When you start going back a long period of time in trying to compare agencies it gets very difficult because of agency restructures, so you don't get a complete series. It's easy to do at a global level and it's easy to do over a couple of years at a disaggregated level, but if you try and go back for a long series of disaggregated, you have to have a broken series. Infrastructure, Energy and Resources might not have been the same five years ago and therefore you've got this broken series.

CHAIR - But Health is fairly consistent.

Mr FERRALL - Health and Human Services would be relatively consistent.

CHAIR - I know there are always variables but it gives us an idea.

Mr FERRALL - Health would be relatively consistent for probably 10 years-plus but if you try to compare them to the others it will not work.

CHAIR - Thank you both very much.

THE WITNESSES WITHDREW.