Having a Budget

Most people use a budget to manage their household spending. We take a similar approach to manage spending on medicines. Having a budget means you have to take a disciplined approach to spending to make sure you get the most from your money. In our case, we’re making choices to try to get the best health outcomes for New Zealanders from the money available for pharmaceuticals.

What’s Special About Medicines?

Medicines are the only part of the NZ health sector where a separate government agency manages a defined budget held by District Health Boards. The emphasis on ‘manages’ is important: PHARMAC does not hold the money as it continues to be held and spent by DHBs, with the exception of the Discretionary Pharmaceutical Fund (DPF) that is held by PHARMAC.

What is the Combined Pharmaceutical Budget for?

This budget is for subsidies for community medicines and some medical devices (those medicines dispensed by your pharmacist), vaccines, haemophilia treatments and cancer medicines which are given in hospitals. It does not include other hospital medicines, which are funded from DHB hospital budgets.

PHARMAC’s operating budget is a separate amount of money that is used to meet the day-to-day costs of running PHARMAC, and is set by the Minister of Health. It also includes the Discretionary Pharmaceutical Fund (DPF) which is a multi-year fund of not more than 2 percent of the value of the CPB.

Payments for distribution, such as the fees that your pharmacist receives for dispensing medicines, are not included in the CPB and are paid from DHB budgets via the Ministry of Health’s centralised payments service.

The Discretionary Pharmaceutical Fund (DPF)

In 2010/11 PHARMAC established a Discretionary Pharmaceutical Fund (DPF) that can be used to provide additional funding to DHBs. The fund was established by the Minister of Health to enable retention of pharmaceutical funding across financial years. This allows PHARMAC to take advantage of investment opportunities that might not otherwise be able to be funded in that year, as well as deal with the sometimes lumpy effects of growth in pharmaceutical usage.

The fund only provides DHBs with a contribution for funding decisions taken by PHARMAC in accordance with its Operating Policies and Procedures. In turn, DHBs top-up the DPF in order to ensure it maintains a minimum opening balance of $10 million (or 1% of the value of the CPB whichever is greatest) each year.

3-Year Funding Path

PHARMAC has an indicative 3-year ‘funding path’ for the CPB. This allows us to make medicine investments and be confident that DHBs will still be able to afford those medicines in later years. Without this knowledge, it would be much more difficult to guarantee ongoing medicine subsidies for patients.

Monitoring Expenditure and Forecast

To stay within budget, we constantly monitor medicines usage and must forecast future expenditure before deciding to subsidise new medicines. This involves making a range of assumptions about factors such as demand trends for existing medicines and likely future use of newly funded medicines. When we’re thinking about subsidising a new medicine we need to weigh up future cost implications against budget projections to ensure we can continue to subsidise that medicine in the future.

Does the CPB Stay Within Budget?

PHARMAC is required by law to manage pharmaceutical expenditure within budget. Our spending decisions directly affect DHBs, who hold the funding for pharmaceuticals. If PHARMAC overspent the CPB beyond the value of the DPF, DHBs would have to reduce their spending in other areas in order to meet this overspend, which could impact other important health areas. If the CPB is underspent, DHBs may repay the DPF up to its maximum value, before retaining the funding for use on other health interventions.

Gross Expenditure and Net Expenditure – What is the Difference?

There are two expenditure figures – gross and net. Gross expenditure is the total amount spent by DHBs before taking into account any rebates they may receive from pharmaceutical suppliers. Net expenditure is the amount spent on the CPB after rebates have been deducted.

Rebates are amounts of money repaid to DHBs (via PHARMAC) by pharmaceutical suppliers based on supply agreements. They are used to reduce the cost of medicines where the pharmaceutical company is unable to notify a lower price (e.g. because of concern over price disclosure or re-export of low priced products). Rebates can also be used to manage risk of expenditure blow-outs by ‘capping’ public expenditure at a certain level, with the company taking on the excess. This is known as a risk-sharing agreement.
MEASURING EXPENDITURE GROWTH

Pharmaceutical prices in New Zealand have fallen significantly over more than a decade. This means that PHARMAC’s purchasing power has increased significantly - three-fold since 1993. Today DHBs are able to subsidise a much higher volume of medicines with, for example, a million dollars, than was possible a few years ago with the same amount of money.

To accurately measure medicines expenditure over time we use a pharmaceutical price index, which tracks pharmaceutical price movements. The Consumer Price Index (CPI), by comparison, measures changes in the price of general goods and services and has little, if any, relevance to price movements in medicines.

HOW IS THE BUDGET SET?

In 2000 Cabinet agreed that following a process of consultation with DHBs and forecasting by PHARMAC, the Ministry of Health would advise the Minister of Health on the notional pharmaceutical budget for PHARMAC to manage the Pharmaceutical Schedule.

THE BUDGET SETTING PROCESS IS AS FOLLOWS

**STEP 1** DISCUSSION

We discuss the level of funding for the CPB for the coming year, as well as for two years into the future, with DHBs. We provide DHBs with a budget proposal based on an analysis of usage trends and potential new investments.

**STEP 2** RECOMMENDATION

After discussion, we make a budget recommendation to the Minister of Health, either a joint recommendation with DHBs or separate recommendations, and we advise the Ministry of Health. This includes a recommendation for the coming financial year as well as a likely range for the budget for the following two out-years.

**STEP 3** ADVICE

The Ministry of Health provides advice to the Minister on the PHARMAC/DHB proposals.

**STEP 4** DECISION

The Minister makes a decision and advises PHARMAC and DHBs of the confirmed budget.

**STEP 5** PUBLICATION

The confirmed budget for the coming financial year is publicised by the Minister, generally in association with the Government’s Budget announcements in May each year.