Health FAQs for the confused

- by: *Henry Ergas*
- From: *The Australian*
- March 05, 2010 12:00AM

The government needs to explain how its medical reforms are going to work.

HERE are some frequently asked questions about the government's proposed hospital plan.

lWill it solve the healthcare funding problem?

Difficult to see why it would.

True, the states may not have the tax base to easily fund rising health costs. But if you believe the recently released Intergenerational Report, neither does the commonwealth. There is no magic pudding in the basement of Treasury that will allow the commonwealth to painlessly finance what the states cannot.

lWhat about the third of GST taken from the states? Won't that allow the commonwealth to fund rising hospital costs?

Yes, but only by making it impossible for the states to pay their share. The accounting on this is tricky, not least because the government has released about as much information on the financials as Communications Minister Stephen Conroy has on the costs and benefits of his broadband network. But here are some sums.

The 2009-10 Intergenerational Report projects that GST revenue will average about 3.5 per cent of gross domestic product during the next 40 years. One-third of GST revenue would therefore be 1.15 per cent of GDP. The report also projects that commonwealth spending on hospitals amounts to 1 per cent of GDP in 2009-10, increasing to 1.1 per cent of GDP in 2019-20.

In other words, the GST revenue the government intends to take back from the states is roughly equal to the entire amount the commonwealth was already projected to spend on hospitals. Since the commonwealth's share of spending is only set to rise as a result of the plan by about 0.20 per cent of GDP, this looks like a huge windfall for the commonwealth, while stripping the states of more than $140 billion (in present value) during the next 10 years.

Claims that the plan is a way of strengthening the states' finances seem bizarre. But even if that were the objective, the way to address it would be to fix the states' tax base, rather than slashing their funding.

lWill it stop cost shifting?

Again, difficult to see how. True, the transfer to the commonwealth of full funding responsibility for hospital outpatient services will remove one area where cost shifting can be

a significant problem. It is also true the states will bear a somewhat lower share of the hospital bill and hence will have less incentive to shift costs.

But, at 40 per cent of public hospital outlays, the states' share will be high enough for cost-shifting games to remain attractive, not least for the commonwealth. Moreover, with aged and mental care excluded from the plan, the problems of co-ordinating hospital and non-hospital services will remain acute.

lWill it stop the blame game?

Hardly. The proposed governance arrangements are clear as mud. Boards will run local hospital networks to performance targets set by the commonwealth. How these boards are appointed, controlled and (if they fail to perform) dismissed is not yet known. What is known is that the bulk of the funding for the boards will come from case-mix payments (see below) set by an independent regulator. But states remain responsible for 40 per cent of the funding, will have key planning functions and will continue to own the public hospitals and employ their staff.

Overall, the spaghetti-like chart for the scheme could have been devised by Barry Jones: little wonder it hasn't been released. The bottom line: everyone will still have someone else to blame.

lBut won't hospitals become more efficient?

Here the government's hopes seem pinned on case-mix funding. The idea is straightforward: hospitals get paid a set amount for each procedure, depending on the estimated cost of undertaking that procedure efficiently.

This is indeed a good idea, but it is no cure for baldness. One problem among others. If case-mix funding is applied strictly, it creates strong incentives to control costs, but at the expense of quality, and exposes hospitals to great financial risk. But if it is not applied strictly, then the incentives for efficiency may evaporate.

Patients are not widgets, capable of being treated at a standard cost. Treatment costs vary greatly, so a payment pegged to average cost makes dealing with the tough cases unattractive. The temptation, therefore, is to shift those cases elsewhere in the system or, if forced to take them, to control costs by skimping on quality. Regulators can use instruments to prevent that skimping, but there are many limits on how effective that can be.

At the same time, hospitals will keep a lid on costs only if bad things happen when costs exceed revenues. In the US, loss-making hospitals get taken over or even shut down. But hospitals may incur a loss simply because they are unlucky and draw a large number of high-cost cases. When this occurs, good hospitals can contract, while hospitals that skim off the low-cost patients prosper.

So some income smoothing mechanism is needed, along with a means of compensating those hospitals that take on the riskiest, costliest patients. In many countries, this involves low-cost hospitals financing high-cost hospitals.

But European experience shows this undermines the incentive to be efficient. The result is cost blow-outs, invariably followed by a reversion to micro-management from the centre, compromising cost efficiency and local responsiveness. The harm would be acute under the government's scheme, as the micro-management would be from Canberra.

The government has said nothing about how any of these predictable difficulties will be addressed. Without specifics, claims of increased efficiency are little more than assertions.

lSo why are they doing it?

Cynics say this plan was made to be rejected. Perhaps, for it is difficult to believe the states could, within a month, sign on to it. Not merely would it strip them of substantial revenues but so far, the proposal has fewer verifiable details than your average Nigerian email scam. That is a pity, for there is certainly plenty to fix.

And who knows, there may be credible arguments for Rudd's plan. If there are, it's time for him to explain them.