Extending the Use of Co-payments in New Zealand Healthcare

Treasury University Challenge 2013

Jeff de Jong

Bachelor of Commerce (Economics)

University of Otago

Core text count: 1,981 words

Introduction

Public health expenditure in New Zealand has been projected to rise, as a proportion of nominal GDP, from 6.8 percent in 2012 to 10.8 percent in 2060 (New Zealand Treasury, 2013). Much of this growth can be attributed to factors which are not easily controlled by government policy, such as income growth, ageing population and the healthcare sector's low productivity gains relative to the rest of the economy. The government currently funds in excess of 80 percent of healthcare in New Zealand. Accordingly, this forecasted growth represents a significant problem in maintaining a quality healthcare system without adversely affecting opportunities in other areas of government spending, such as education and welfare.

Several methods for mitigating this increased pressure on government expenditure have been suggested, including extending the use of co-payments. The purpose of this essay is to examine the pros and cons of such a method in the context of Treasury's Living Standards Framework, examining the effects this policy may have on each of the five key dimensions of living standards: Sustainability for the Future, Economic Growth, Increasing Equity, Social Infrastructure and Managing Risks. The specific design of an extended system of co-payments, however, will not be discussed.

Sustainability for the Future

Sustainable development is defined in the living standards framework as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" (New Zealand Treasury, 2013). The significant projected growth of public health expenditure raises questions as to the sustainability of not only the healthcare system, but also other government funded systems such as education and welfare. In particular, the outcome of extending co-payments on New Zealanders' ability to access human capital,[1] through their level of health both now and in future; and the continued availability of human and social

[1] Human capital is one of five capitals, the others being social, natural, physical and financial, identified as contributing to higher living standards for New Zealanders (New Zealand Treasury, 2013).

capital, through government spending for other priorities; should be examined in order to determine this policy's effect on sustainability.

The present overall health of New Zealand's adult population appears to be good, as 89 percent of adults identify themselves as having excellent, very good or good health (Ministry of Health, 2012) and in order to be sustainable, the extension of co-payments should not adversely affect this. The effects of introducing cost-sharing for healthcare on both utilisation and health outcomes were studied by Brook, et al, in the RAND Health Insurance Experiment, which found that despite higher utilisation rates, those with free healthcare were not significantly healthier than those without (cited as Rice & Morrison, 1993). Given these findings, it appears that increasing co-payments is unlikely to adversely affect the overall level of health of New Zealanders in the present.

Childhood health has significant effects on educational attainment, and socioeconomic status and health in adulthood (Case, Fertig, & Paxson, 2005). As such, the effect of extending co-payments on childhood health is likely to be an indicator of the effect on the overall health of New Zealanders in the future. The RAND experiment found little evidence of significantly better health in children with free healthcare (cited as Rice & Morrison, 1993), which suggests that extending co-payments is unlikely to adversely affect the health of New Zealanders in future.

In order to meet their needs, future generations must continue to have access to publically provided goods such as welfare and education. Health expenditure is projected to grow from 22 percent to 31 percent of government spending (New Zealand Treasury, 2013), reducing the pool of funds available for public goods such as education and welfare. Extending co-payments should simultaneously yield a decrease in demand for health services[2] and reduce the public component of healthcare expenditure, thereby making the healthcare system more sustainable and reducing pressure on government finances. It should be noted, however, that publicly-financed healthcare systems generally contain costs more successfully (Docteur & Oxley, 2003) and as such, a balance between private and public payments should be struck.

[2] Ringel, Hosek, Vollaard, & Mahnovski (2002) find that estimates of the price elasticity of demand centre at -0.17 so that a 10 percent increase in price yields a 1.7 percent decrease in healthcare expenditure.

Extending co-payments should mitigate growth in demand for healthcare services and reduce pressure on government finances, without significantly reducing the overall level of health enjoyed by New Zealanders. As such, it has the potential to improve present and future access to human and social capitals, thereby increasing sustainability.

Economic Growth

Economic growth, in this context, refers to "the level and growth of average income of New Zealanders" (New Zealand Treasury, 2013). To determine the effects of extending co-payments on economic growth, it will be important to examine the effects of reducing pressure on government finances.

As noted above, healthcare is expected to rise from 6.8 to 10.8 percent of nominal GDP by 2060. This has significant implications for other areas of expenditure: education, in particular, is expected to fall as a proportion of GDP over the same interval, potentially harming stocks of human capital and reducing capacity for growth. Extending co-payments will, as noted above, reduce pressure public healthcare expenditure growth, allowing a greater proportion of spending to be allocated to education. As such, human capital stocks, and therefore opportunities for economic growth, may be improved.

The funding structure of the healthcare system also has important consequences for economic growth. As previously mentioned, government is responsible for over 80 percent of healthcare expenditure, the revenues for which are collected mainly through taxes,[3] which are distortionary in nature. Diewert and Lawrence (cited as Bates, 2001) conservatively estimate the marginal excess burden associated with labour taxation at 18 percent,[4] suggesting there are substantial gains from reductions in government spending. Therefore, reducing growth in public healthcare expenditure will aid economic growth.

[3] Two-thirds of government revenue was collected through taxes (New Zealand Treasury, 2012) of which labour taxes are a significant component.

[4] Bates suggests that the marginal excess burden of taxation is closer to 50 percent when capital is also considered, which would imply that a $1 reduction in tax revenue yields a $1.50 increase in private surplus.

Extending co-payments decreases pressure on government finances, reducing the need for spending on education to decline. This will aid formation of human capital. Furthermore, mitigating growth in public expenditure will significantly reduce the excess burden of taxation. Accordingly, extending co-payments will encourage economic growth.

Increasing Equity

Equity, in the context of the Living Standards Framework, refers to New Zealand's historical "commitment to equal rights, a safety net that protects the vulnerable, and the opportunity to participate in society" (New Zealand Treasury, 2013). Further, equity encompasses allocating resources to where they will yield the greatest benefits and rewarding individuals according to their effort. Extending co-payments has the potential to influence equity in several ways, such as reducing utilisation of healthcare for vulnerable groups and altering the distribution of resources. It is also important to note that the design of an extended system of co-payments is particularly important to equity considerations.

The 2011-2012 New Zealand Health Survey found that those living in socioeconomically deprived areas, and Maori and Pacific peoples had greater unmet need for health care and a generally poorer level of overall health than other groups (Ministry of Health, 2012). It was found that cost, in particular, was a significant factor in failing to access healthcare services, such as GP appointments and prescription medications, despite existing co-payment subsidies[5]. Therefore, in the absence of effective targeting of co-payments, any adverse effects are likely to be felt proportionately more by these demographics resulting in reduced equity.

Publically funded healthcare also has an important role in redistribution, as it allocates resources based on need rather than ability to pay. Extending the use of co-payments may reduce this level of reallocation[6] and therefore harm equity;

[5] The Community Services Card, for example, is freely available to low- and modest-income earners and reduces the level of co-payments on some healthcare services.

[6] Brook, Ware, Rogers et al, found that among adults subject to cost sharing, low-income earners consumed proportionately fewer healthcare services (including those deemed "highly effective") than their middle- and upper-income counterparts (cited as Rice & Morrison, 1993).

however, effective targeting of co-payments may mean that resources can be better directed towards areas which will yield the greatest benefits, potentially increasing the level of equity.

Greater use of co-payments also has the potential to reduce moral hazard and over-consumption associated with healthcare services by forcing consumers to bear part of the costs, although inherent market capture may somewhat negate these benefits. Extending co-payments may also act as an incentive for people to engage in healthier behaviours, by rewarding those who do with lower costs.[7] These will allow greater allocation of resources to areas which yield the greatest benefits, further improving equity.

The overall effect of extending co-payments on equity lies largely in the system's construction. If poorly designed, additional co-payments have the potential to harm those who are most vulnerable and reduce redistribution. Conversely, if co-payments were to be properly targeted, such that the incidence is borne mainly by the least vulnerable in society, equity can be improved.

Social Infrastructure

Social infrastructure is described by Putnam (cited as New Zealand Treasury, 2013) as "features of social organisation, such as trust, norms and networks that can improve the efficiency of society by facilitating coordinated actions." Furthermore, it incorporates concpets such as culture, civil society and social capital (New Zealand Treasury, 2013). In analysing the effects extending co-payments it will be important to consider how elements of social infrastructure, such as participation in society and trust in civic institutions, are likely to be affected; and to note the importance of relationships between social infrastructure and health outcomes.

The negative effects of increasing co-payments, if poorly targeted, are likely to be seen among low-income earners and Maori and Pacific peoples. Poorer health outcomes for these groups will negatively impact their ability to participate in society

[7] Kane, Johnson, Town, & Butler (2004) found that monetary incentives (or the chance to avoid disincentives) were generally effective in increasing utilisation of preventative care, although effects were typically short-run in nature and transmission mechanisms unclear.

and may reduce their level of trust in public institutions. These will lead to an erosion of social cohesion and rising inequality, damaging social infrastructure. Conversely, properly targeted co-payments may particularly benefit these groups, building up social infrastructure.

Scheffler, et al., (2010) note that while causality flows largely from social capital to health, the existence of a mutually reinforcing relationship between the two is intuitively plausible and not able to be rejected empirically, which further underlines the importance of effective co-payment targeting.

The impact of extending co-payments on social infrastructure again lies in the system's design. A well-targeted system of co-payments may improve health outcomes for vulnerable groups, allowing greater participation in society and increased trust in institutions, which may, in turn, further improve health outcomes. Accordingly, social infrastructure is improved.

Managing Risks

Risk "spans uncertain adverse events and their effect on objectives"; terms of the living standards framework, managing risk involves identifying events that may hamper New Zealanders' access to the capitals, and deciding whether, how and when to treat those events (New Zealand Treasury, 2013). The most obvious risks associated with healthcare are to accessing human and social capital, through health and educational outcomes. Furthermore, the government's fiscal position influences the country's ability to withstand shocks and must also be considered.

Publicly funded healthcare allows individuals in society to share risk such that individuals can maintain good health, a component of human capital. Extending co-payments in an effective manner can support continued access to this aspect of human capital by reducing over-consumption and encouraging healthy behaviours, such that resources can be directed to those most in need. Additionally, mitigating growth in healthcare expenditure will allow a greater proportion of spending to be allocated to education, further improving access to human capital.

Through mitigating growth in demand for healthcare services and reducing the public portion of expenditure, extending co-payments can also improve the government's debt position,[8] allowing for greater use of expansionary fiscal policy in the event of an adverse macroeconomic shock.

Extending co-payments can allow New Zealanders greater access to human and social capital by mitigating the risks associated with them, such as falling quality of healthcare and education, and improve our ability to withstand economic shocks, therefore aiding in risk management.

Conclusion

In summary, extending the use of co-payments could be beneficial across each of the five dimensions of the living standards framework, provided that changes are well-targeted.

Such a system would mitigate growth in public healthcare expenditure without reducing New Zealanders' level of health, and therefore their ability to access human capital, increasing sustainability. Further, excess burden of taxation will fall and future educational outcomes may be improved, supporting economic growth. Additionally, redistribution is improved by allowing resources to be allocated more greatly to the vulnerable, increasing participation and fostering trust in public institutions, thus equity and social infrastructure are improved. Finally, extended co-payments will improve access to human and social capital, aiding the management of risk.

[8] Net government debt is projected to rise from 13.9 percent to 198.3 percent of nominal GDP by 2060 (New Zealand Treasury, 2013) and growth in public healthcare expenditure is expected to be a significant driver of this.

References

Bates, W. (2001). *How Much Government? The Effects of High Government Spending on Economic Performance.* Wellington: New Zealand Business Round Table.

Case, A., Fertig, A., & Paxson, C. (2005). The Lasting Impact of Childhood Health and Circumstance. *Journal of Health Economics*, 365-389.

Docteur, E., & Oxley, H. (2003). *Healthcare Systems: Lessons From The Reform Experience (OECD Health Working Papers).* Paric: OECD.

Kane, R., Johnson, P., Town, R., & Butler, M. (2004). A Structured Review of the Effect of Economic Incentives on Consumers' Preventative Behaviour. *American Journal of Preventative Medicine*, 327-352.

Ministry of Health. (2012). *The Health of New Zealand Adults.* Wellington: Ministry of Health.

New Zealand Treasury. (2012, June). *A Snapshot of the 2012 Financial Statements of the New Zealand Government*. Retrieved from New Zealand Treasury: http://www.treasury.govt.nz/government/financialstatements/yearend/jun12snapshot/01.htm#where

New Zealand Treasury. (2013). *Health Projections and Policy Options.* Wellington: New Zealand Treasury.

New Zealand Treasury. (2013, January). *Higher Living Standards.* Retrieved from The Treasury: http://www.treasury.govt.nz/abouttreasury/higherlivingstandards

New Zealand Treasury. (2013). *Quick Guide to Affording Our Future.* Wellington: New Zealand Treasury.

Rice, T., & Morrison, K. (1993). Patient Cost Sharing for Medical Services: A Review of the Literature and Implications for Health Care Reform. *Medical Care Review*, 235-287.

Ringel, J., Hosek, S., Vollaard, B., & Mahnovski, S. (2002). *The Elasticity of Demand for Healthcare.* Santa Monica: RAND.

Scheffler, R., Petris, N., Borgonovi, F., Brown, T., Sassi, F., Dourgnon, P., & N, S. (2010). *Social Capital, Human Capital and Health: What is the Evidence?* Paris: OECD.