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The health sector faces a dual problem. The first is essentially an economic question; the issue of how to keep public health spending at sustainable levels so public health care can continue to be provided. Secondly, how we in New Zealand can justify such huge amounts of spending on health care. This is partly a matter of establishing priorities for social investment.[1]Part payments, for example prescription medicines where the prescription charge is $5 and the rest of the cost is paid by the government, are one way of keeping health care affordable for the government by contribution to costs. Part payments are a front-end deductible form of insurance where the consumer pays a certain amount and the government pays the rest. To keep public health care spending sustainable and as a affordable social investment, part payments in the New Zealand health system must be extended to other kinds of health services which is currently free. Doing this will reduce the issue of moral hazard, the 'free rider' problem, eliminate excess demand and will capture citizens willingness to pay and consumer surplus. However the cons of extending part payments are also serious – with inequality likely to increase as those on lower incomes become less likely to access the adequate health care they need. To minimize this inequality I recommend the level of part payments the government charges should not be increased. If public health care cannot be kept at sustainable levels it will face the risk of being cut or it will use up resources that need to be allocated to other areas such as education. Every choice has an opportunity cost, the next best alternative forgone and health care is an economic good that like other public goods financed by government spending, needs to be rationed.

To first establish whether part payments should be extended or not, I will first set out why we have public health care in New Zealand and why it must be sustained. The government as a public health provider is similar to a private health insurer. The government, however, spreads the risk even further and insures the whole country using revenue from taxes. Effectively the government replaces a private insurer who must combat adverse selection. Adverse selection is due to asymmetric information, where in the Insurance market the consumer knows more information about their health than the insurer. The consumer knows how likely they are to make a claim and therefore only those who are sick will purchase health insurance. When the sick make lots of claims, the cost of health insurance is pushed up. Those who have low incomes (but are in need of health care) are expelled from the market, as they cannot afford to pay the premiums. Insurance companies also have high loading costs and seek profits, so they always charge higher premiums than what is actuarially fair. The New Zealand public health care system is essentially attempting to provide health care for all New Zealanders at a lower cost to the consumer. Health is a key part of subjective wellbeing[2] and from a moral and ethical standpoint a public health system ensures all have access to healthcare. Health care is co-correlated with better education, longer life expectancy and lower crime. A healthy person can contribute to the economy and increase GDP rather than be a burden on

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[1] *Health and Health Care in New Zealand.* Peter Davis, Longman Paul Limited Auckland, NZ. Published 1981, page 11, Chapter 1: Current Issues in health.

[2] *Working towards higher living standards for New Zealanders*. Ben Gleisner, Mary Llewellyn-Fowler and Fiona McAlister, 25 May 2011, page 14.

the state.[3] . Public health care provides protection from anyone incurring unplanned health expenditures, which exceed a certain income and will then push a household into poverty.[4]Therefore we must ensure health care is sustainable by extending part payments.

The main positive of extending the use of part payments is that it will decrease the cost of health care for the government, while still providing it to those in need at a lower cost. New Zealand health care spending for the 2010/11 financial year was $13.8 billion, 19% of overall government spending. [5] With a growing population and the baby boomer generation coming in to older age, the need and therefore spending on health care will only increase. In 2012, Government debt to GDP was 37%, showing NZ is clearly spending at an unsustainable rate. Extending part payments will directly contribute to health care costs and free up funds for other economic goods such as education. It will slow the excess demand of health care, rampant due to the public health system's ability to provide consumers with the ability to increase their utility & maximize consumer surplus at no cost (marginal cost of consumption is equal to zero). This high demand makes supply extremely expensive and part payments are introduced to dampen excess demand and capture peoples willingness to pay, increasing marginal cost of consumption over zero. Under a zero pricing system, such as the public health system we have, the optimal amount of information about direct costs for any consumer to collect will be zero. The costs of these consumer's choices are spread across the whole of the country and the burden upon him is effectively zero. On the other hand the collective cost of all similar decisions on society as a whole is clearly substantial. By imposing a direct cost on the consumer through part payments, the burden upon consumer is no longer zero.[6] They are therefore more inclined to 'shop around' for the cheapest option, decreasing the collective burden on the government and overall cost of providing health care in the process.[7] Essentially, part payments minimize the cost of health care to provide, dampen excess demand and create an incentive for consumers to seek out cost effective treatments.

Extending part payments also fights moral hazard – a term describing the situation when someone becomes more careless when they know they are covered cost wise for health care in an accident. This in turn leads to an increase in the cost of providing free health care as utilization is increased. [8]If the cost of care increases from zero, they are less willing to take risks with the knowledge that in the event of an accident, they have to pay. The freed rider problem (someone who benefits from resources, goods, or services without paying for the cost) is also minimized with

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[3] *Introduction to Health Economics.* Lorna Guiness and Virginia Wiseman. October 2011. McGraw-Hill International

[4] *Introduction to Health Economics.* Lorna Guiness and Virginia Wiseman. October 2011. McGraw-Hill International

[5] Source: the New Zealand Treasury (2011)

[6] Trudy Sullivan, Econ306, Lecture Slides.

[7] Trudy Sullivan, Econ306, Lecture Slides.

[8] Trudy Sullivan, Econ306, Lecture Slides.

more consumers paying their willingness to pay and contributing to costs. It is also less rational to utilize medical care unless you actually need it when you are contributing to costs. As Arrow points out, many do not put constraints on themselves when demanding zero cost health care and demand over their needs[9]. Increasing part payments will also help combat these issues, but the consequences of this action will outweigh the positives, as I will come to later.

The most prominent negative to extending part payments and increasing part payments to other services within the public health care system is essentially the detrimental effects of such an action on the lower income earners in New Zealand. Effectively as we increase and extend part payments we are shifting less from a progressive contribution to health care (where higher income earners pay a higher proportion) to a more proportional or user pays system of financing health care.[10] This however can be viewed, as a positive or negative depending on you own personal views. There are many compelling arguments for a user pays system such as the total elimination of moral hazard and the free rider problem. However I interpret this as a negative as lower income earners "have the greatest need for health care due to their economic vulnerability which makes them more prone to illness" [11]In 2011 roughly 15% of children in New Zealand lived in households below the poverty line. [12] Families with low incomes are just one example of people in society who cannot afford healthcare, even $5 for a simple prescription. In 2011 roughly 15% of children in New Zealand lived in households below the poverty line. [13] With a increased cost attached to consuming health care, those with low disposable incomes are unlikely to consume it, even if they are in extreme need. This often leads to a situation where they become sicker and their eventual treatment costs more to the New Zealand health System than if they had been treated sooner. With a cost attached to consuming health care, those with low disposable incomes are unlikely to consume it, even if they are in extreme need. From an ethical and moral standpoint, this is also likely to cause extreme distress and unhappiness damaging to our subjective wellbeing. It will also, as previously mentioned, damage that consumer's ability to consume education or participate in the economy.

I recommend extending part payments through NZ but not increasing the level of part payments. There are many services in the country that are completely free, for example family planning services for those under the age of 22, Dentist visits for

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[9] *Economic Equilibrium.* Arrow, Kenneth J 1968. In D. L. Sills (ed.) International Encyclopedia of the Social Sciences. London and New York: Macmillan and the Free Press

[10] *Introduction to Health Economics.* Lorna Guiness and Virginia Wiseman. October 2011. McGraw-Hill International

[11] *Introduction to Health Economics.* Lorna Guiness and Virginia Wiseman. October 2011. McGraw-Hill International

[12] The children's social health monitor, New Zealand. http://www.nzchildren.co.nz/child_poverty.php

[13] The children's social health monitor, New Zealand. http://www.nzchildren.co.nz/child_poverty.php

those under the age of 18 and many more.[14] If the total cost of a service is only slightly above the part payment, many individuals will choose not to claim. So if we extend the part payments scheme to other areas, but keep the contribution low, for example $2 to visit the dentist as an under 18 there will still be some contribution to costs without significantly lowering the demand from the lower class. Lower income earners have a high elasticity of demand when it comes to health care, so we must keep the part payment level low to ensure health care is accessible for the lower class. This will ensure we get maximum use or benefit out of providing health care and all can access it. If we increase the level part payments many essential services will be unaffordable for the majority. Providing health care to all at zero cost so lower income earners could have access would be optimal but in reality it is unaffordable and unsustainable. Some level of "user pays" must be established for New Zealand to continue to provide sustainable health care. Therefore in order to keep health care sustainable, costs must be decreased by an extension of part payments through health services already provided.

In conclusion, the New Zealand public health system comes from a moral or ethical standpoint that in the 21st century everyone should have access to universal health care. New Zealand, as part of the World Health Organization, is committed to its goal to "ensure that all people obtain the health services they need without suffering financial hardship when paying for them".[15] To ensure this promise can be kept, spending on health care must also be sustainable. We must balance this goal with our other goal of sustainability to find the optimal amount of part payments to charge. To ensure New Zealand can continue to provide public health care, part payments must be extended throughout health services. However the level of this payment must be kept at a low cost.

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[14] Ministry of Health, http://www.health.govt.nz/new-zealand-health-system/publicly-funded-health-and-disability-services.

[15] World Health Organisation, Internet Homepage. http://www.who.int/universal_health_coverage/en/