

# How fair is health spending?

## The distribution of tax subsidies for health in Australia

Julie Smith Number 43 October 2001

THE AUSTRALIA INSTITUTE <http://www.tai.org.au> accessed 1 April 2004

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Discussion Paper Number 43

October 2001

ISSN 1322-5421

### Acknowledgements

The historical data series used in this study was originally compiled in collaboration with Dr James Butler (Senior Research Fellow, National Centre for Epidemiology and Population Health, Australian National University) and funded by the Australian Tax Research Foundation.

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## Executive Summary

Private health insurance incentives will cost Australian taxpayers \$3 billion a year in less than eighteen months if the Federal Government's 30 per cent rebate for private health insurance rises at the rate presently forecast by the Treasury.

While the costs of the new concessions for private health insurance have escalated, the rebate has failed spectacularly to reduce public sector health spending or increase membership of private health funds. It has also contributed to a burgeoning Commonwealth Government health care bill exceeding 48 per cent of Australia's health care costs.

In addition the private health insurance concessions strongly favour wealthy households. Previous analysis by The Australia Institute exposed the inequity of the superseded income-tested incentive scheme. Using new Taxation Office data on the 30 per cent rebate scheme, this study shows a substantial worsening of the inequity. The latest data shows that approximately half of the present open-ended subsidy for private health insurance goes to the top 20 per cent of taxpayers and nearly three quarters goes to the top 40 per cent.

The rising Commonwealth share of health costs and declining role of private health funds have been at the centre of health financing policy debate in recent years.

Seeking to encourage greater private provision for health, the Howard Government introduced the 30 per cent rebate for the costs of private health insurance in 1999.

This replaced the failed income-tested incentive for private health insurance introduced from June 1997.

The 30 per cent rebate has proved very expensive. The cost to the budget of private health insurance was around \$1.6 billion in 1999-2000, and will increase further following the large jump in health insurance coverage from mid-2000. The sharp increase in coverage was not due to cash incentives for fund membership. The increase resulted from deregulation of health funds and the introduction of life-time health cover rules.

### **Equity effects**

This paper shows that instead of encouraging private provision, concessions for private health insurance have been a financial windfall for wealthy households. Since the 1960s, the benefits of tax concessions for private health insurance have been enjoyed disproportionately by the wealthiest households. This regressive pattern was interrupted by the replacement of tax deductions with rebates from the 1970s. The introduction of the 30 per cent rebate in 1999 reversed the improvements in equity in the previous two and a half decades. Current tax relief for private health insurance provides an annual per capita payment of around \$744 for taxpayers earning \$1,000,000 per annum in 1998-99. This is about twice the \$388 received by the average taxpayer.

The 30 per cent rebate for private health insurance is even more concentrated in the wealthiest households than tax deductions were in previous decades. Half the revenue forgone by the concession accrues to those in the top 20 per cent of taxpayers, compared to 26 per cent under the previous means-tested scheme.

The Commonwealth Government's subsidy of private health insurance means that Australian taxpayers have indirectly paid for around \$360 million of private dental care, and around \$430 million of private health fund administration costs during the period June 1997-June 2000.

Some affluent Australians may believe they are improving the fairness of the system and helping Medicare by taking out private insurance, but the extent of the public subsidy and its unequal distribution exposed in this study means they are being misled.

### **Public health cutbacks**

The cost of providing subsidies for private health insurance is placing pressures on the Commonwealth health budget and draining funds from public hospitals and other public health priorities.

While public sector cutbacks over the last decade have resulted in queues in public hospitals and the axing of public dental care services, the Federal Government now provides a large public subsidy through the private health insurance rebate for high-income earners to jump hospital queues, obtain cosmetic surgery and dental care, and pay for their gym club membership.

As financial incentives for private insurance now account for around 7 per cent of Commonwealth health funding, and are growing rapidly, subsidies for private insurance must be at the expense of additional funding for Medicare. Each year, the

private health insurance rebate alone is drawing around \$2 billion of government funding away from public health care provision.

Current health policy directs an increasing portion of scarce Commonwealth health funds towards the top end of the income stream regardless of demonstrated health needs and public health priorities. While more than half of the current tax rebate for private health insurance goes to the wealthiest 20 per cent of households, the number of public hospital beds has declined by 3 per cent a year since 1996-97.

Present deregulatory trends point to an emerging policy of allowing private health insurance funds to cream off the most profitable part of the Australia's health insurance market, while leaving an underfunded public hospital system to provide care for the bulk of those with urgent or chronic health care needs.

### **Reforms needed**

The existing cash incentives and tax rebates for private health insurance are in urgent need of reform so that they are less costly, less inequitable, and more likely to substitute for public funding of hospital care. Likewise, the existing tax rebate for net medical expenses should be revamped to provide more equitable access for lower income groups, while limiting its costs to the public purse. These necessary reforms include:

- removing health insurance cover for ancillaries from the 30 per cent health insurance rebate so that the Commonwealth contributes less to the elective health care expenditures of the well-off;
- replacing the present open-ended rebate for private health insurance with a fixed rebate to limit the extent of subsidy and make the subsidy fairer; and
- making payments under the 30 per cent rebate for private health insurance taxable, to make it more equitable and bring it into line with other government cash payments and transfers that are taxable (like social security benefits).