

Tough choices: how to rein in Australia's rising health bill

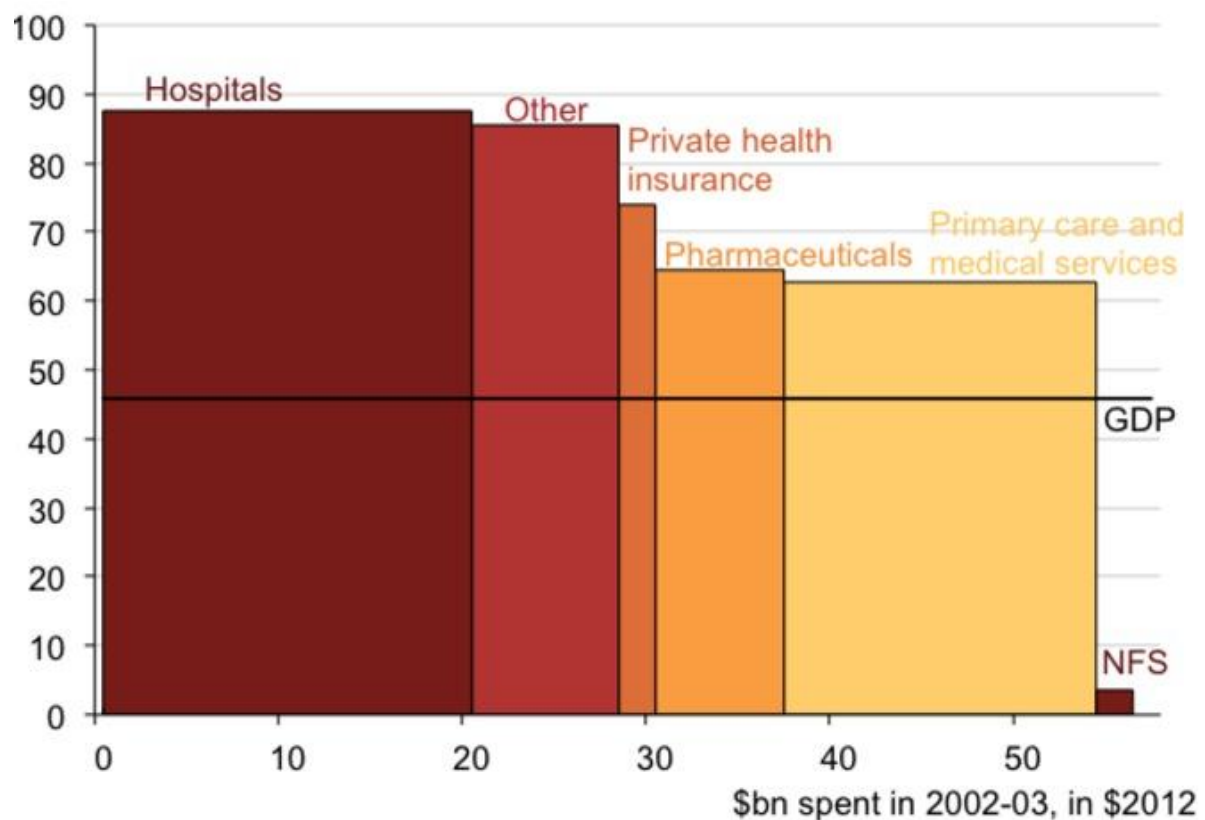
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Health spending is eating up more and more of government budgets, both state and federal. In fact, government health spending grew 74% over the past decade, far faster than GDP, which grew by 46% above CPI.

Health spending started from a large base too. Australian governments are spending almost A\$42 billion more this year in real terms on health than they did a decade ago, compared to A\$28 billion more on welfare and A\$22 billion more on education.

For government budgets, health is a big deal and getting bigger. Grattan Institute's new report, [Budget Pressures on Australian Governments](#) shows that health expenses are 19% of Australian government budgets (state and federal), compared to 17% in 2002 to 03.

Although all categories of government health spending are growing, some are growing faster than others.



Change in total government health payment expenditure by sub-category, 2002-3 to 2012-13, % change above CPI. Grattan Institute.

The biggest and fastest-growing spending category in health is hospitals – they get almost A\$18 billion in real terms more than in 2002-03, an increase of over 95%.

The next biggest category is primary care and medical services, which includes Medicare. It has grown by over 60%, accounting for a further A\$11 billion increase.

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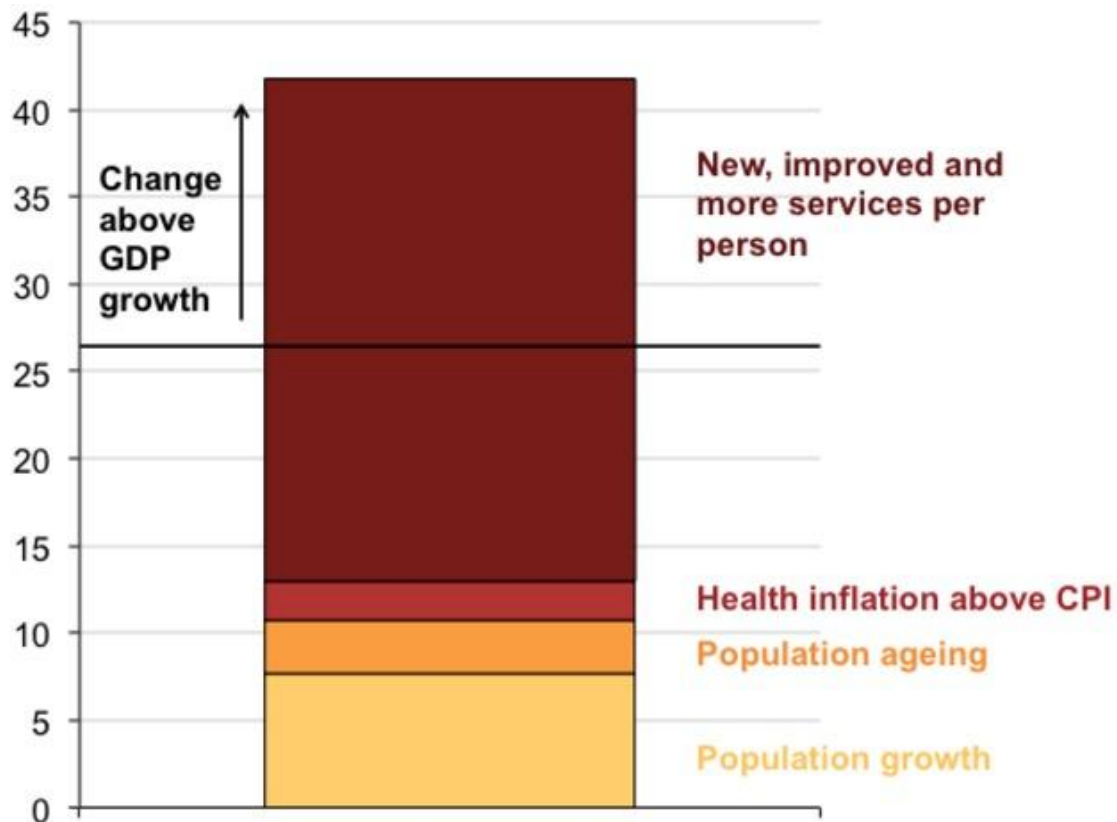
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Other areas of health, such as pharmaceuticals and subsidies for private health insurance, have grown substantially but off much smaller bases.

Why are health costs rising?

Received wisdom is that rising health costs are all about demographic change, but this is not true. Together, population growth and the ageing population structure accounted for only a quarter of government expenditure growth above CPI since 2002-2003. A further 5% of the growth comes from health inflation growing faster than CPI.



Drivers of change in government health expenditure, 2002-03 to 2012-13 (A\$bn in real terms). Grattan Institute

The rest of the increase is due to people of all ages getting more and more expensive services per person. On average, a 50-year-old now is seeing doctors more often, having more tests and operations, and taking more prescription drugs, than a 50-year-old did ten years ago. The quality of the treatment they are getting has improved in many cases, and there are new treatments that did not exist in 2003.

There's no reason to think that this trend will slow down in the next ten years without major policy reform. Government health spending now consumes an additional 1% of GDP compared to a decade ago; this is projected to increase to 2% in the next ten years.

Both costs and benefits

Spending more on health is not necessarily a bad thing – in fact, it's exactly what you would expect an advanced, prosperous economy to do. The [international evidence shows](#) that as economies grow, so too does health spending.

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We can treat all sorts of conditions more effectively now than we used to, and it's having an impact. Life expectancy for those aged 65 has been rising rapidly since 1970. Death rates from conditions where health care **might make a difference** are going down.

But someone is going to have to pay for the better treatment that benefits us all. Tough policy choices will need to be made to either increase government revenues, or keep a lid on costs.

How to reduce health spending

Reducing health spending growth will not be easy. As Grattan's **Game-changers** report last year showed, Australia already has one of the OECD's most efficient health systems, in terms of life expectancy achieved for dollars spent.

Sweeping cuts to health funding, or shifting costs to consumers, could have serious consequences. Blunt cost-cutting risks reducing health and well-being, and could ultimately lead to higher government costs due to illness, increased health-care needs and lower workforce participation.

But not every dollar we spend on health care is well spent and the best way to start is by focusing on efficiency. One area we do know that there's room for improvement is pharmaceuticals. As Grattan's report **Australia's Bad Drug Deal** shows, Australia's Pharmaceutical Benefits Scheme pays at least A\$1.3 billion a year too much for prescription drugs.

There are real savings to be made from reforming our drug purchase process, bargaining harder on generic drug prices, and encouraging drug substitutions.

In terms of hospital efficiency, which varies greatly across the country, governments have agreed to introduce a new funding formula, based on paying for **hospital activity** using a "national efficient price". This is a good first step to reduce waste, but there is more room for reform.

Under current public hospital funding arrangements, the "national efficient price" pays extra for complex patients, regardless of whether the complexity is caused by things that happened after the patient was admitted or whether they arrived at the hospital in that condition. Why do we still pay more to hospitals which have higher rates of mistakes or mishaps?

Getting rid of waste sounds easy, but every dollar of health spending is someone's dollar of income, and there are plenty of vested interests who want to keep their revenue stream.

Of course, not all health spending is waste, not by a long shot. But even if we make tough choices about waste, we might still be left with the next choice. Do we want to put our hands in our pockets to fund more health care with increased taxes, or will something else have to give?

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