Private Healthcare Australia
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Press Release

9th February 2012.

Government Means Testing Modelling Flawed.

An independent report released today exposes flawed Treasury modelling in relation to the Government's proposal to means-testing the 30% Rebate on Private Health Insurance.

"Members of Parliament still making up their minds on this important issue need to realise that the Treasury figures on which the Government is relying are fanciful and should not be used as a basis for making a decision which will disadvantage their constituents," said Private Healthcare Australia CEO, Dr Michael Armitage.

"Minister Plibersek, like Minister Roxon before her, claims that means-testing the 30% Rebate will save $100 billion over the next 40 years.

"The Government has failed to release the modelling to substantiate that claim and now a report by Booz & Co exposes the Government modeling as both flawed and misleading.

"The Booz & Co Report highlights that the Rebate has remained as a constant 3.5% of total public and private health expenditure over the last decade, and is a "small component of total healthcare spend (8.1%)" and has only increased 0.2% over the last 10 years.

"Previous claims that the Rebate is the fastest growing area of health expenditure are also false.

"The Booz & Co report demonstrates that nobody should rely on the Government's modelling and that there are not the savings to be found from this measure as claimed.

"The report supports claims that means-testing the 30% Rebate is poor public policy. And we know from the Deloitte Report last year that means-testing the Rebate will end up costing government more within five years as spending on public hospitals will need to be increased as people drop and downgrade their private cover.

"Taking away the 30% Rebate from people who are taking responsibility for their own health care needs by being privately-insured is poor health policy and it will have a detrimental effect on the entire health system.

"All private health fund members will pay extra for their health insurance in subsequent years if this legislation is passed, and Members of Parliament should reject the legislation because it will impact negatively the healthcare of all their constituents.," said Dr Armitage.

Further Information: Jen Eddy 02 62021000

COMMERCIAL IN CONFIDENCE

CONFIDENTIAL

Private Health Insurance Rebate Means Testing

Assessment of Select Claims

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The Government is arguing for the introduction of means testing to the private health insurance rebate it currently provides

- The Australian Government tabled the *Fairer Private Health Insurance Incentives Bill 2011* in conjunction with other proposed changes in the MLS to Parliament
  - This legislation aims to introduce a 'means test' for receipt of the Private Health Insurance (PHI) rebate, effectively reducing the rebate amount for those on higher incomes
  - Similar bills were previously submitted to Parliament in 2009 and rejected
- Since the introduction of this bill, several surveys, reports and statements have been released, including the Deloitte report [1] and the ANOP report [2]. The Deloitte and ANOP survey explore the potential of these changes to result in a high drop out and downgrading of PHI membership which would have a flow on effect to the rest of the healthcare system
- Government has referred to Treasury modelling and predictions about the rising cost of the rebate, as well as potential savings flowing from introduction of the means test. It has pointed to the *Intergenerational Report 2010* as evidence for its claims
- **Private Healthcare Australia has requested Booz & Company to independently assess the latest claims of the Government [3], specifically:**
  - **that the rebate is the fastest growing area of health expenditure and that this is problematic**
  - **that means testing would result in budgetary savings of $100B over 40 years**

Source: 1) Deloitte, 'Economic Assessment of the Proposed Reforms to Private Health Insurance' (2011); 2) ANOP, Means Testing the Private Health Insurance Rebate: The Impact on Private Health Insurance Membership in Australia' (2011); 3) Department of Health & Ageing, 'Means Testing of Government Rebates for Private Health Insurance', http://www.health.gov.au/internet/main/publishing.nsf/Content/currentissueP11000027 (6 Jan 2012)

Several questions must be addressed to debate the current growth rate for the rebate and the total savings from means testing

Means-Testing the PHI Rebate – Issues and Questions

Issues	Questions
1 Rate of Growth of the Rebate	▪ What significance does the PHI rebate have in the total government health expenditure? ▪ What significance does the PHI rebate have in the total overall health expenditure? ▪ Is the rebate the fastest growing area of health spend? ▪ What will the total rebate amount be in 2019?
2 Projection of Savings from Means-testing the Rebate	▪ Is it appropriate to use a 40-year projection of savings in this situation? ▪ How accurate has the Treasury been in other forward projections? ▪ What is the expected reliability of a 40 year projection in the current environment?

The PHI Rebate is a small component of total healthcare spend and over the last 10 years, has remained stable as a proportion

Claim Posed by Government for Means Testing

"The Treasury Department's Intergenerational Report 2010 *showed that the private health insurance rebate will be the fastest growing component of Government health expenditure over the next 40 years."*

Department of Health & Ageing
06 Jan 2012

Critique of Claim

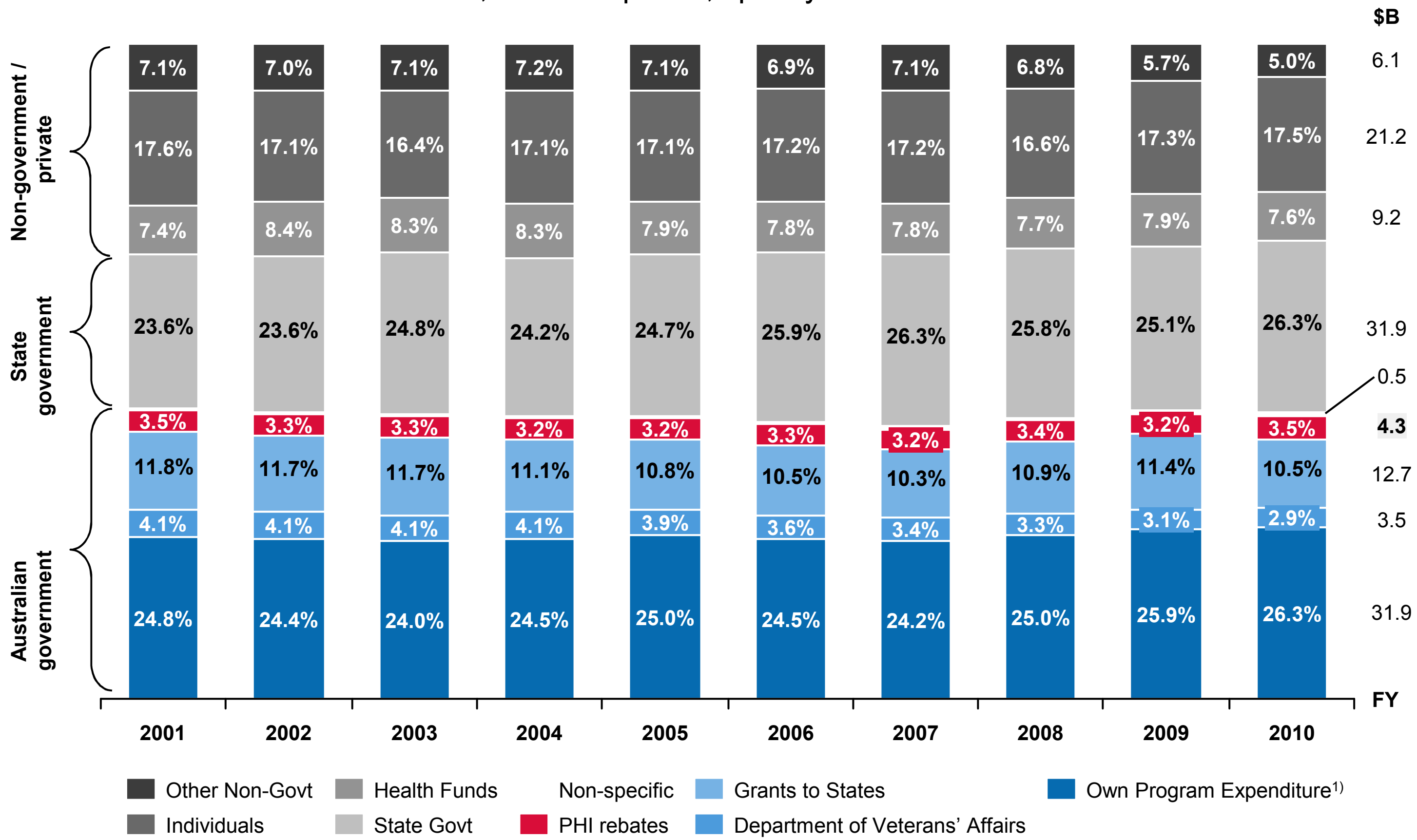
- **a** The rebate amount represents 3.5% of total public and private healthcare spend, the same as it was 10 years ago
- **b** The PHI Rebate is a small proportion of Government health spend (8.1%) and has only increased 0.2% as a proportion over 10 years
- **c** The PHI Rebate has been growing at ~7.5%pa[1)], but compared to other rising health costs, is not the fastest growing component
- **d** To reach the $10B rebate in 2019 as claimed in media sources, growth would need to be significantly higher than in the past
- **e** Assuming the rebate remains 3.5% of total health spend, the rebate would reach $10B more than 9 years later than currently stated

1) Real Growth rate based on the growth in rebates from FY1999-00 to FY 2009-10 (adjusted for effects of inflation)
Source: Department of Health & Ageing, 'Means Testing of Government Rebates for Private Health Insurance', http://www.health.gov.au/internet/main/publishing.nsf/Content/currentissue-P11000027 (6 Jan 2012)

The rebate amount is only 3.5% of total public and private healthcare spend, the same as it was 10 years ago

Australian Total Health Expenditure

FY2001-2010; constant prices; split by source and use of funds



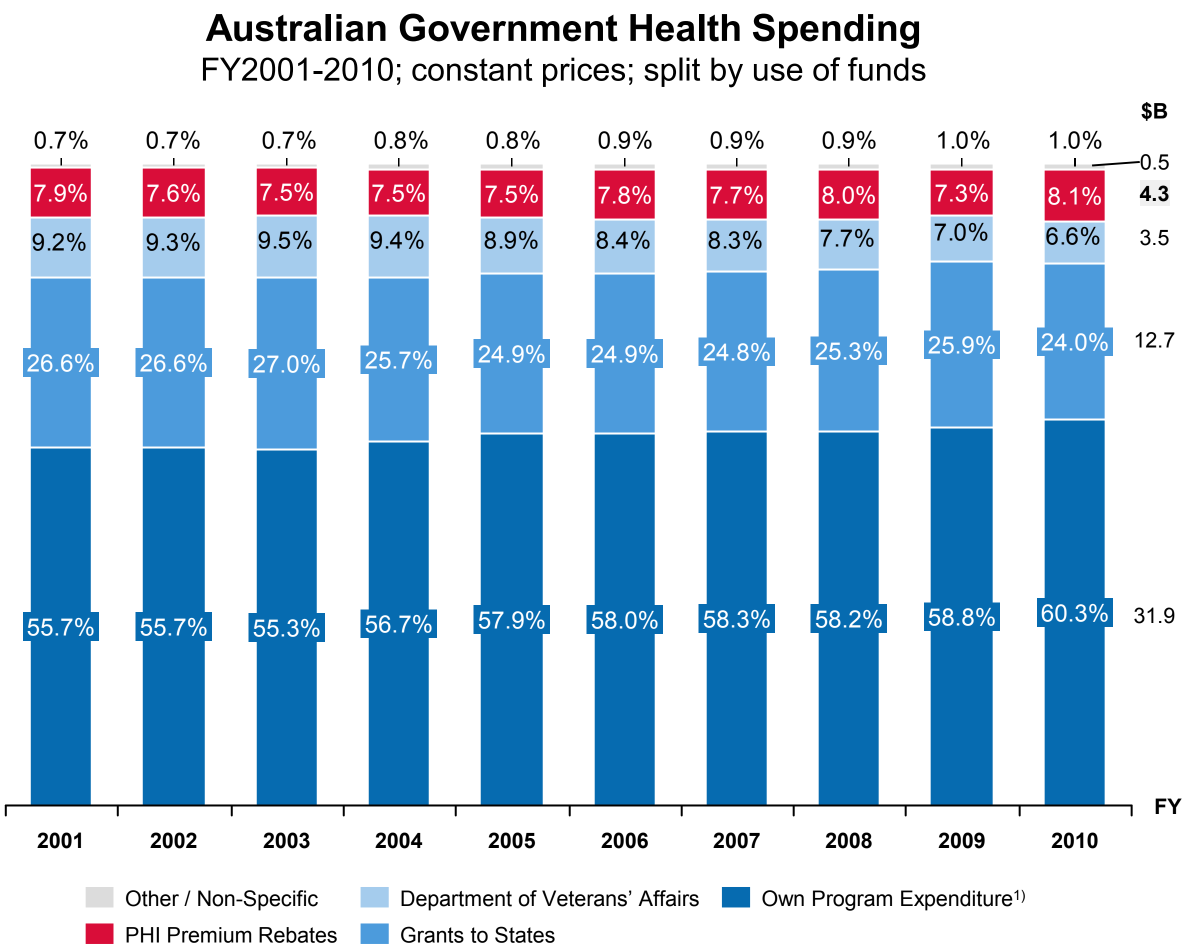
Insights

- PHI rebates have remained a relatively small amount (i.e. ~$4.3B) of total health expenditure
- While the PHI rebate has increased in absolute terms, it represents the same proportion of total health expenditure as it did in 2001 (i.e. 3.5%)

1) Represents government outlays on health programs mostly administered by the Department of Health & Ageing, e.g. MBS and PBS

Source: Australian Institute of Health and Welfare, 'Health Expenditure Australia 2009-10' (2011), Booz & Company analysis

The PHI Rebate is a small component of Government health spend (8.1%) and has only increased 0.2% as a proportion over 10 years



1) Represents government outlays on health programs mostly administered by the Department of Health & Ageing, e.g. MBS and PBS

Source: Australian Institute of Health and Welfare, 'Health Expenditure Australia 2009-10' (2011), Booz & Company analysis

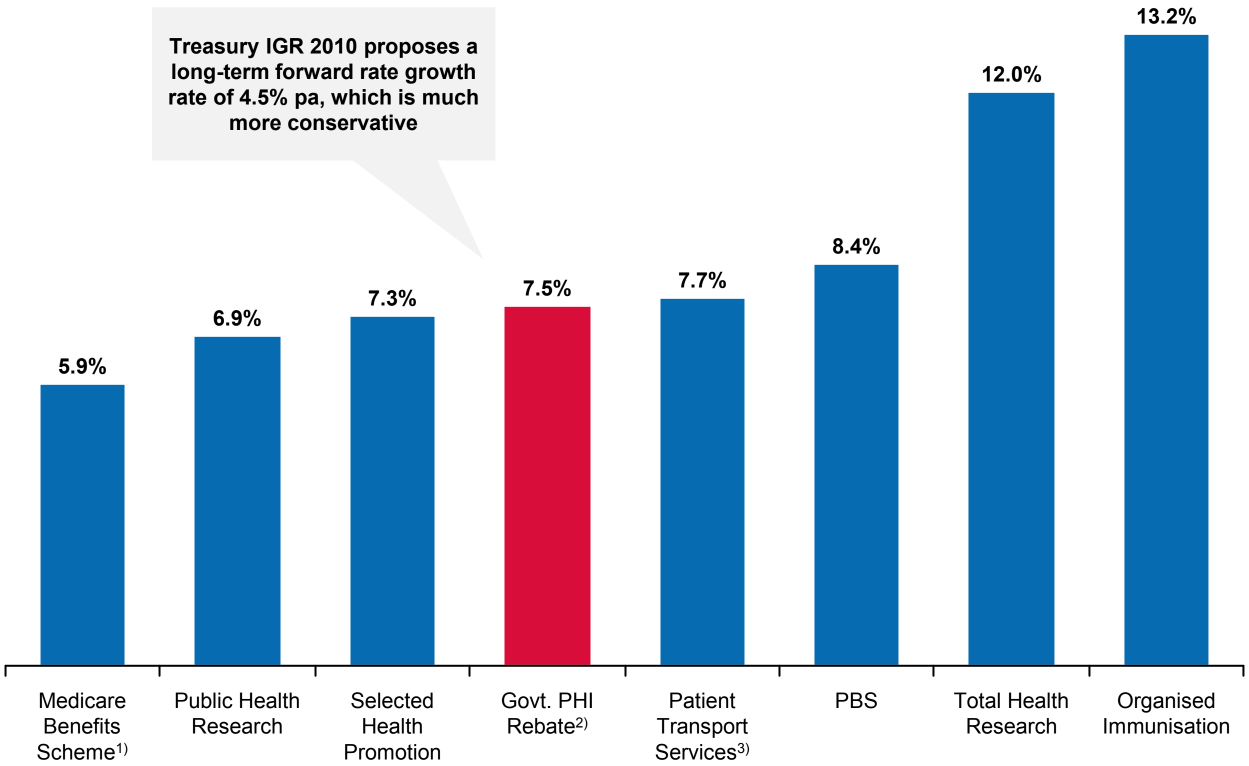
Discussion

- PHI is a small proportion of total public healthcare spend, representing only 8.1% of overall government outlays on health spend in 2010
  - This proportion has only changed from 7.9% to 8.1% since 2001 (i.e. a total of 0.2%)
- While the PHI rebate may be growing fast relative to its low base amount, its small size means it has a very minor impact on overall spending
- Other factors have outstripped the effect of PHI increases in absolute terms, in particular 'Own Program Expenditure' (which includes PBS and MBS) has grown 4% over the same period and accounts for 60% of the total healthcare outlays for the Australian Government
- The 'Own Program Expenditure' category can be broken down to reveal that there are other sub-categories of spend which are actually larger and growing at a faster rate than the PHI rebate

The PHI Rebate has been growing at ~7.5%pa, but compared to other rising health costs is not the fastest growing component

Historical Real Growth Rates in Spend by Area

FY1999-00 to FY2009-10



Insights

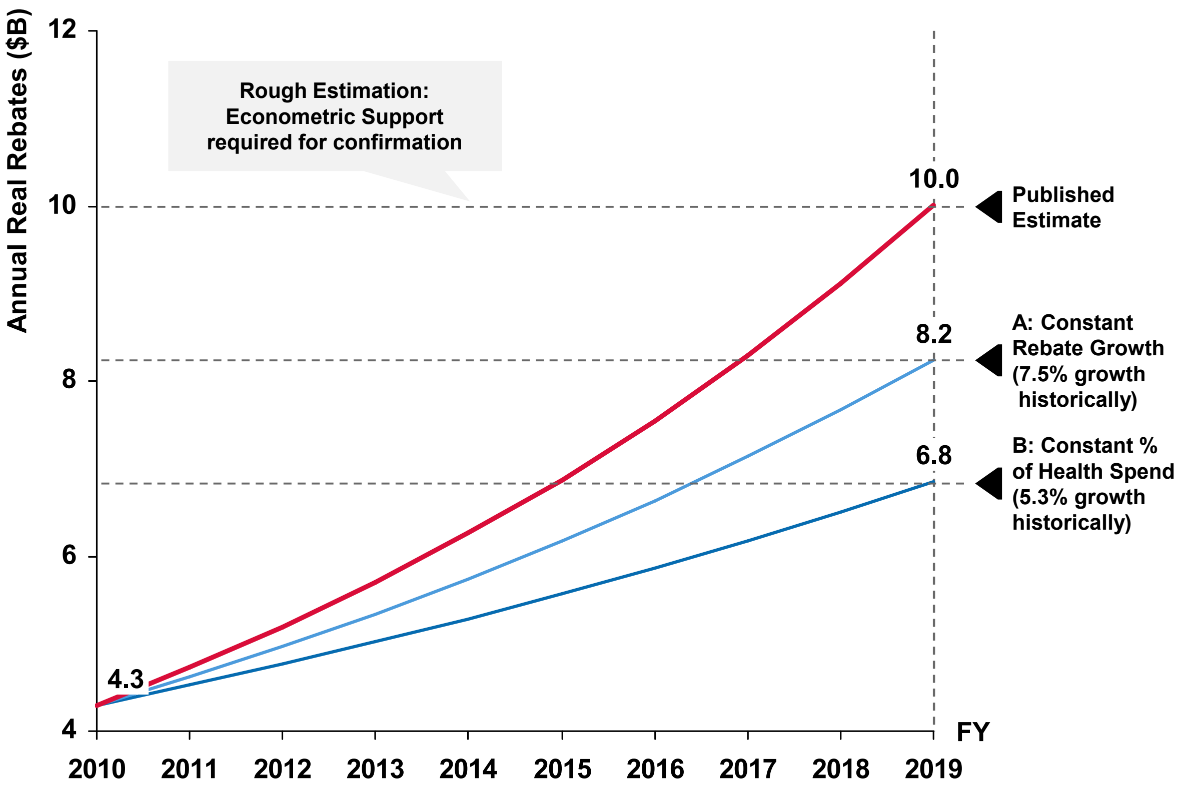
- Historically the PHI rebate has grown at 7.5%pa. This has been driven by a number of factors including government regulated premiums, increasing population and increasing participation in private health insurance (hospital and ancillary cover)
- The PHI rebate has not been the fastest growing component of healthcare spend when compared with Patient Transport Services (7.7%), PBS (8.4%), Total Health Research (12%) and Organised Immunisation (13.2%)
  - If historical growth rates continue, PBS would double in 9 years to reach $20B

1) Growth in Medicare Benefits Scheme spend is only based on data from 2003-2010 due to limited data availability
2) Real Growth rate based on the growth in rebates from FY1999-00 to FY 2009-10 (*adjusted for effects of inflation using the CPI index for 2000-2010)*
3) Growth in Patient Transport Services spend is only based on data from 2004-2010 due to a break in the series

Source: Australian Institute of Health and Welfare, 'Australia's Health 2010' (2010); Private Health Insurance Administration Council 'The Operations of Private Health Insurers: Annual Report 2010' (2010), Productivity Commission, 'Quality of Care in Australian Public and Private Hospitals' (2010); Booz & Company analysis

To reach the $10B rebate in 2019 as claimed in media publications, growth would need to be significantly higher than in the past

Projection of Total Rebates
FY2009-10 to FY2018-19

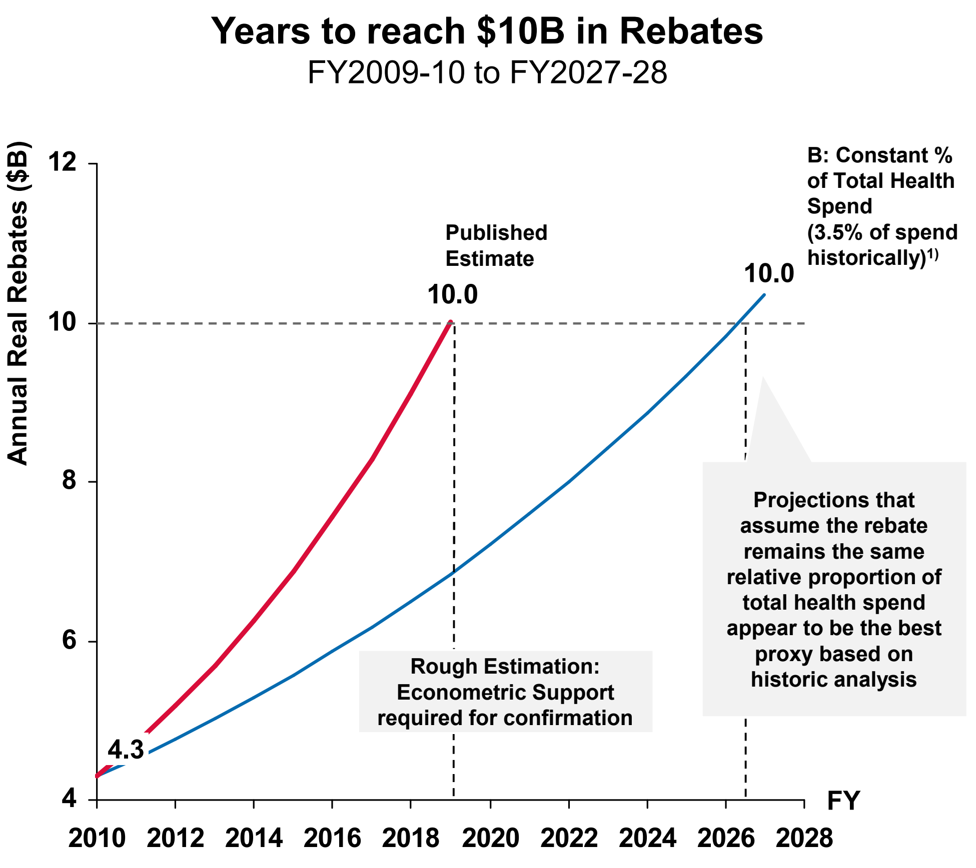


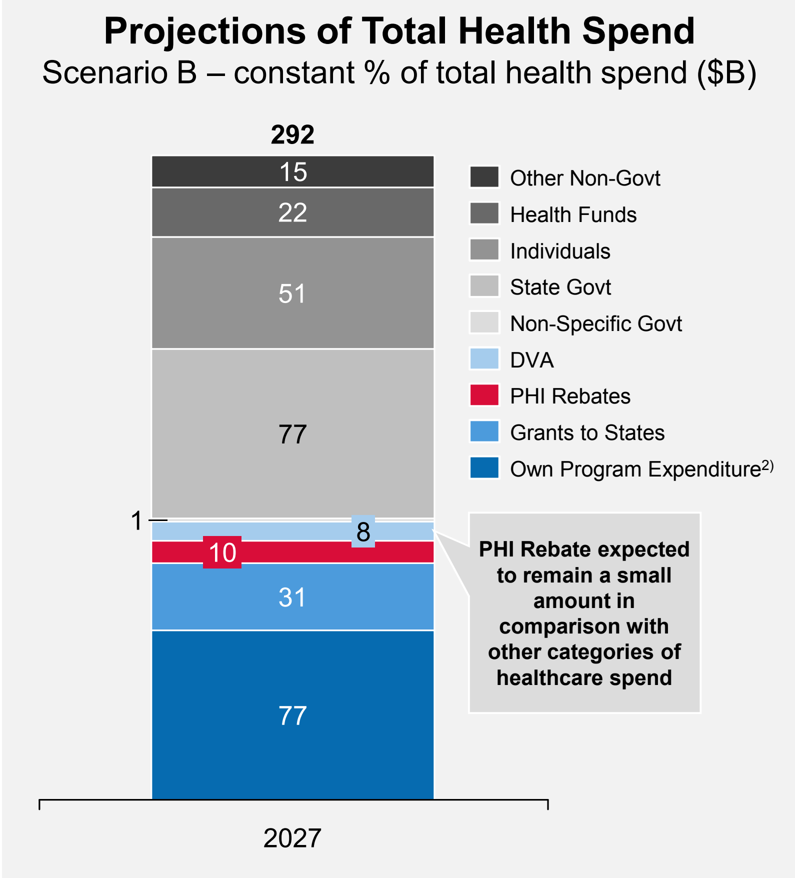
Insights

- In recent published estimates, the statement that rebates will double in value to $10B by 2019 appears to be very aggressive as shown by high level analysis:
- Based on the two scenarios of rebate growth:
  - as a constant historic rate, the real rebates would reach $10B by **FY2021-22**
  - as a constant % of total heath spend, the real rebates would reach $10B by **FY2026-27**
- In Scenario A, to reach $10B by 2019, the **real growth rate of rebates would need to be 9.8% as against the historic growth rate of 7.5%**
  - Alternatively, the population would have to grow by 1.5% instead of the 1.2% currently projected by Treasury (i.e.~830k more people than projected by IGR in 2019)
- In Scenario B, to reach $10B by 2019, the **real growth rate of total health expenditure would need to be 9.8% as opposed to the historic growth rate of 5.3%**
  - Alternatively, the population would have to grow by 2.2% instead of the 1.2% currently projected by Treasury (i.e. ~2.4 million more people that projected by IGR in 2019)

Source: AHIA, 'Health Expenditure Australia 2009-10 Report' (2011); Commonwealth Treasury, 'Intergenerational Report 2010' (2011); PHIAC Annual Report (2010); Private Healthcare Australia; Booz & Company analysis

Assuming the rebate remains 3.5% of total health spend, the rebate would reach $10B more than 9 years later than currently stated





1) Scenario B is used instead of Scenario A as proportion of total health spend historically is a better proxy for approximation
2) Represents government outlays on health programs mostly administered by the Department of Health & Ageing, e.g. MBS and PBS
Source: AHIA, 'Health Expenditure Australia 2009-10 Report' (2011); Commonwealth Treasury, 'Intergenerational Report 2010' (2011); PHIAC, Annual Report (2010); Private Healthcare Australia; Booz & Company analysis

Treasury has proposed that introducing means testing will save the Government $100B over 40 years, however this is misleading

Claim Posed by Government for Means Testing

"Treasury has calculated that not passing the Private Health Insurance Incentives Tiers is likely to cost $100 billion over the next 40 years" [1)]

Department of Health & Ageing
06 Jan 2012

To date the only data points provided to substantiate the figure of $100B savings over 40-years are that the savings are "*worth $768M for 2012-13*" and that the means-testing bill is "*worth $2.8 billion to the Federal Budget over four years*"

Critique of Claim

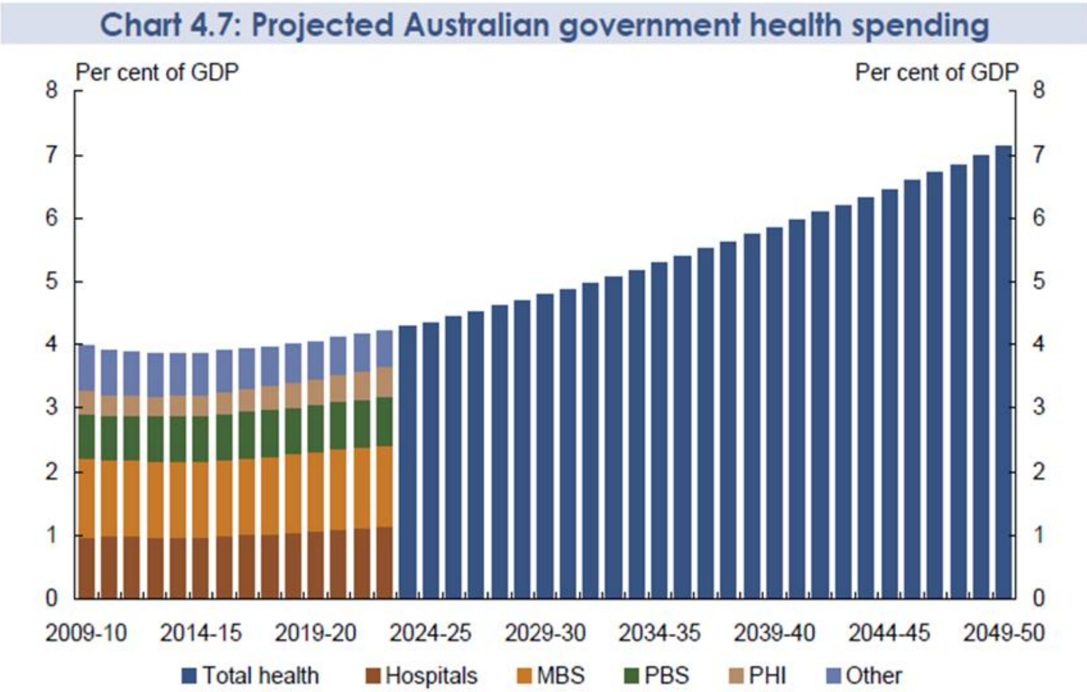
- a. Treasury has acknowledged limitations in accurately estimating healthcare component costs over a 40-year period
- b. In previous budgets Treasury forecasts have varied over 25% from the actual outcome when estimating 2-3 years out
- c. Sensitivities in long-term modelling and unforseen events, such as GFC, make long-term projections even less reliable for decision-making

Source: 1) Department of Health & Ageing, 'Means Testing of Government Rebates for Private Health Insurance', http://www.health.gov.au/internet/main/publishing.nsf/Content/currentissue-P11000027 (6 Jan 2012); 2) *The Australian*, "Private rebate bill gets new life HEALTH ",(30 Nov 2011); *Fairer Private Health Insurance Incentives Bill 2011*;

Treasury has acknowledged limitations and flaws in accurately estimating healthcare component costs over a 40-year period

Treasury Guidelines on a 40-Year Estimate

Extract from Intergenerational Report 2010



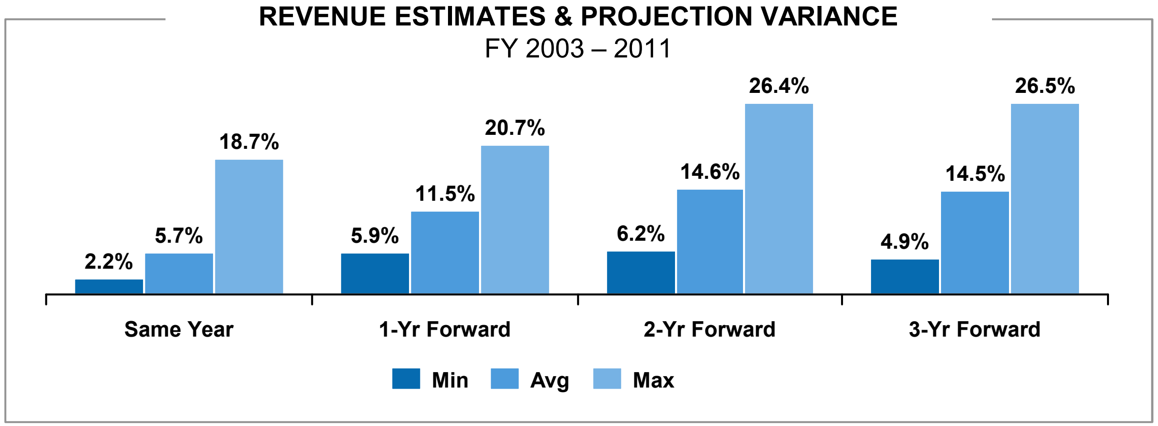
Observations

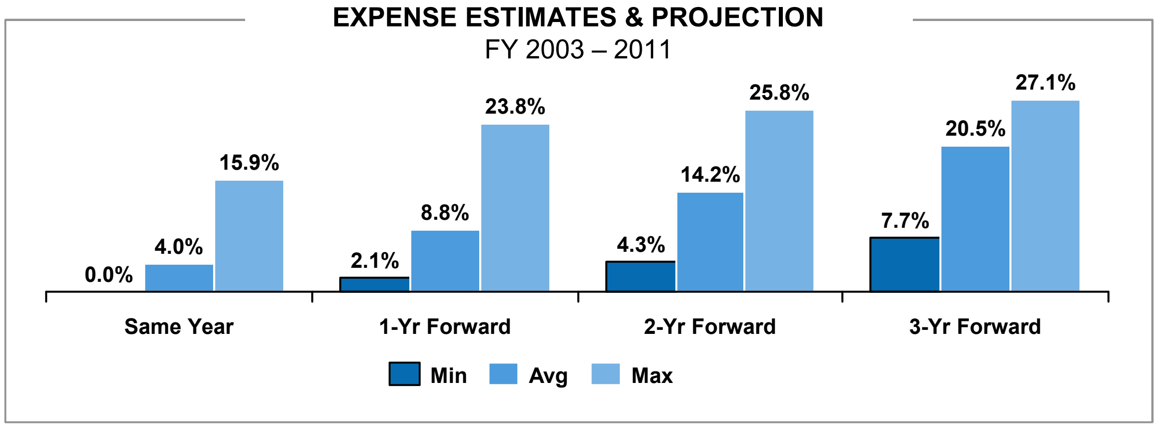
- Treasury uses aggregate models for long term trends with individual components of the health spending projected over the medium term only
  - The *Intergenerational Report 2010,* Treasury makes projections on the individual components up to 2022-23 only and uses an aggregate model for the remaining years till 49-2050 as that is *"based on more stable long-term trends"*
  - The report also mentions that PHI rebates have been projected using a exponential model with a growth rate of ~4.5% p.a. with the reasoning being that it provides the '*greatest explanatory power*'*.* The other components such as MBS and PBS have been projected on a linear growth form
- In another Treasury Model, TRYM, the model assumptions state that *"…results should be treated with caution"* because "*Policy analysis… involves making judgments about how responses from people… may change over time, including in anticipation of policy change.*"

Source: Commonwealth Treasury, 'Intergenerational Report 2010' (2011); Commonwealth Treasury, "The Macroeconomics Of The TRYM Model Of The Australian Economy' (1996); Booz & Company analysis

In previous budgets Treasury forecasts have varied over 25% from the actual outcome when estimating 2-3 years out

Variance of Treasury Budget Estimates from Final Outcome





Insights

- Whilst Treasury is arguably in the best position to forecast the Australian economy, as is the case with all forecasts, there is a margin of error that must be taken into account when using future projections
- Forward estimates of Revenue and Expenses in past budgets were compared to the actual figures released in the Final Budget Outcome. Analysis reveals an:
  - Potential error in estimation of same year revenues from **2.2%-18.7%** and expenses up to **15.9%**
  - Potential error in 3-yr forward projection increases to **26.5% and 27.1% for revenues and expenses** respectively
- Media articles have further highlighted previous errors made by Treasury in their projections:
  - Treasury forecasts of growth in 2010-11 were revised from 2.25% to 1.75% by the Reserve Bank and further updated to 1.9%[1)]
  - Budget forecasts for 2010-11 over-estimated the government collection by $1B and missed the superannuation tax earnings figure by 8%[2)]

Source: 1) *The Australian*, 'Figuring out Treasury's Wrong Numbers' (11 November 2011); 2) *The Age*, 'Predictably Forecasts can be Wrong' (2 November 2011); Booz & Company analysis

Sensitivities in long-term modelling and unforseen events, such as GFC, make long-term projections less reliable for decision-making

Difficulties in Making Long-Term Projections

Sensitivity of Large Number of Variables in Long Term Modelling	▪ 40 year projections cannot be relied upon as they do not consider many qualitative variables and Black Swan (e.g. Berlin Wall) events such as: – Structural changes in the industry – Major technology and healthcare innovations – Policy changes from future Governments – 2008 Financial Crisis ▪ In the Senate, Treasury has been criticised for not incorporating the impact of the global economic crisis and not incorporating all scenarios in their '*Economics of climate change mitigation'* October 2008 Model [1)]
Current Uncertainty in the Global Markets	▪ World Bank claims that *"there is a risk of a 'much broader freezing up of capital markets and a global crisis similar in magnitude to the Lehman crisis'"* [2)] ▪ IMF states that *"Europe's debt crisis could suddenly intensify, sparking another financial crisis that would quickly spread around the world"* [3)] ▪ Other Press Releases report that *"the combination of huge sovereign debts and vulnerable banks could trigger another financial crisis"* [4)] and "*it has again become clear that regulators cannot predict the specifics of the next crisis"* [5)]

Source: 1) Senate Standing Committee on Economics, 'Exposure draft of the legislation to implement the Carbon Pollution Reduction Scheme (April 2009); 2) *Sydney Morning Herald*, 'World Bank's Crisis Warning' (18 January 2012); 3) *The Australian,* 'Economic headwinds may not blow too strongly here', 25 Jan 2012; 4) *Washington Post*, 'Is Another Financial Crisis Near?' (16 September 2011); 5) *The International Herald Tribune*, 'What U.S. has Learned from Crises', (24 Dec ember 2011);