Chapter 7 CONSEQUENCES OF MAINTAINING EXISTING FINANCING MODEL

Existing Financing Arrangements

7.1 In the case of Hong Kong, to maintain the existing financing arrangements would mean continuing to rely on government revenue to meet the increasing expenditure required to meet healthcare needs. Unless we are prepared to accept significant deterioration in the level and quality of healthcare offered by the public hospital system (see Chapter 1), this would mean that additional revenue will have to be raised by one or more of means such as increasing tax rates, broadening tax base and increasing non-tax revenue, assuming that we cannot substantially cut into other areas of public expenditures.

Financing Implications

7.2 It is estimated that, if any extra funding required for public healthcare under the current healthcare system were to be met in full by government revenue, our total public expenditure would have to be increased to 22.1% of GDP and the share of public expenditure for health in the total public expenditure would be increased to 24.8% in 2033.

7.3 Meeting the increased public expenditure requires an increase in government revenue, which could mean substantial increases in Salaries Tax and/or Profits Tax rates, unless we introduce new sources of revenue including broadening tax base or increasing non-tax revenue. The expansion of total public expenditure would also be contrary to the existing policy of limiting total public expenditure to below 20% of GDP.

7.4 On the other hand, if the total public expenditure is to be kept below 20% of GDP, public health expenditure would take up 27.3% of total public expenditure in 2033, at the expense of funding for other public services (e.g. the share of funding for education, social welfare or security, which account for some 23.8%, 17.6% and 11.8% of recurrent government expenditure in 2008-09, may have to be reduced).

Overseas Experience

7.5 Direct funding from government revenue for healthcare is the predominant means of financing in Australia, Canada, Finland and the UK, apart from Hong Kong. In the case of all these advanced economies, they have much higher personal income tax rates, ranging from 40.0% to 48.8% excluding social security contributions, compared with 16.0% in Hong Kong (standard rate of Salaries Tax in

2007-08). All of these economies have sales tax as a source of revenue. Their public expenditure as a percentage of GDP is also much higher, ranging from 34% to 51%, compared with 19.7% in Hong Kong (in 2004-05).

7.6 In all these economies, similar to the case of Hong Kong, invariably a major challenge to the publicly-funded healthcare system is the rise in the cost of healthcare services, due to both ageing population and advances in medical technology. This is further aggravated in the case of Canada where a fee-for-service model[7] is adopted which renders control in utilization and cost much more difficult. In face of the challenge, the economies have responded differently.

7.7 Canada has been debating the merit of expanding the private sector by allowing more provisions of services by private healthcare providers and a greater share of private health insurance in financing, with little consensus for action. In the case of Australia, the government has responded by encouraging the public to take out private health insurance with a view to reducing demand on public hospitals (see Chapter 11), with some success but also leaving some questions to be answered on the long-term viability of this approach.

7.8 The UK responded by significantly expanding public spending on healthcare, largely because of the recognition that healthcare in UK has been under-funded in comparison with most other Western European countries in at least the last two decades. There are however concerns on the ability of the government to sustain the level of spending on healthcare, when faced with the prospect of big budget deficit.

Advantages of Existing Financing Model

7.9 The current financing system has the following advantages –

(a) **Equitable healthcare**: a publicly-funded healthcare system provides every member of the public with equitable access to the same level and standard of healthcare services at the same highly-subsidized rate regardless of means, through queuing, rationing, or triage on the basis of clinical needs, or a mix of these.

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[7] Fee-for-service in healthcare services or health insurance context means that doctors and other healthcare providers receive a fee for each service provided, such as a consultation, test, procedure, or other episode of administering healthcare service. Fee-for-service health insurance typically allows patients to obtain care from doctors or hospitals of their choosing, but in return for this flexibility they may pay higher copayments or deductibles.

(b) **Simple and low-cost administration**: with well-established mechanisms for the collection of tax and adjustment of tax rates, financing healthcare by increasing the existing types of taxes is simpler to administer and incurs less extra cost, unless new types of taxes were to be introduced.

(c) **Wealth re-distribution**: financing healthcare by tax revenue has the effect of requiring taxpayers with higher income to subsidize the healthcare for the rest of the population. It should however be noted that the current public healthcare system funded by government revenue already achieves a significant degree of wealth re-distribution, and it is for consideration if it would be necessary to achieve further wealth re-distribution through the supplementary financing.

Shortcomings of Maintaining Existing Financing Model

7.10 Relying on government revenue as the sole financing for healthcare has the following shortcomings –

(a) **Rising tax bills and expanding government budget**: financing healthcare solely with government revenue will eventually result in continued increase in tax rates and expansion of public expenditure in the economy, departing from the small government principle and low tax regime, which are key to our competitiveness. Our Salaries Tax already rests on a relatively narrow tax base. Our reliance on Profits Tax is already high compared to OECD countries, and headline corporate tax rate in many economies, including our main competitors, has been decreasing. Any increase in Profits Tax rate will adversely affect Hong Kong's competitiveness. It is doubtful if it would be viable to raise the rates of existing taxes to a significant extent in order to meet the increasing healthcare expenditure. Meanwhile, no consensus has been reached in previous consultation to broaden the tax base.

(b) **Increasing burden on future generations**: the tax burden on the future generation would become greater as Hong Kong's demography changes to a smaller working population supporting a larger elderly population. The share of government expenditure on healthcare that each taxpayer would have to shoulder in twenty years' time would be much larger than that of the taxpayer today, when on the one hand public health expenditure is projected to increase significantly in real terms at a much faster pace than the economy, and on the other hand the proportion of labour force in the population is projected to continue to shrink.

(c) **Encourage over-reliance on highly-subsidized public healthcare and aggravate public-private imbalance**: even putting aside financial affordability, relying solely on government revenue to finance healthcare would mean perpetuating the current public-dominance in provision of hospital services, and in turn the current structural imbalance between the public and private healthcare sectors. The continued provision of highly-subsidized public healthcare services would inevitably encourage further reliance on public healthcare services, further expanding the share of public sector in the healthcare market, and further aggravating the public-private imbalance and not conducive to stimulating healthy competition in the market.

(d) **Lack incentives for judicious use of highly-subsidized public healthcare and not conducive to enhancing public sector efficiency and cost-effectiveness**: the continued highly-subsidized healthcare services offered by the public system would not provide enough incentives for judicious use of such services. With healthcare services provided predominantly by the public system financed by government revenue on a block-grant approach, and with virtually no competition from the private sector, there is no added incentive for the public sector to drive for even greater cost efficiency and cost-effectiveness.

(e) **Inadequate choice in healthcare services**: healthcare services provided by the public healthcare system financed by government revenue are supply-controlled, and will inevitably involve queuing and waiting for healthcare services, as well as allocation of services based on clinical needs assessed according to established criteria and protocols. In providing equitable access, a tax-funded healthcare system can only provide services within prescribed scopes, including specified formulary, to eligible members of the public. It will therefore limit choices and thus competition between the public and private sectors in providing healthcare services.

(f) **Unsustainable financing**: the current tax-base is narrow and government revenue is relatively dependent on economic cycles. It would not be sustainable to continue to increase the share of health expenditure in government budget without limit, and the limit will be affected by the economic performance of Hong Kong.