

PRIVATE HEALTH INSURANCE – FAIR AND SUSTAINABLE SUPPORT FOR THE FUTURE

Costing details:

DATA

- The Treasury personal income tax micro-simulation model (which is based on confidentialised sample 2005-06 personal income tax data) was used to estimate the number of people in the affected income ranges and age ranges.
- PHIAC data on private health insurance membership as at 31 December 2008 (Private Health Insurance Administration Council, A Report, December 2008 quarter, p.1)
- Current PHI rebate expenditure as outlined in the Department of Health and Ageing (DoHA) Portfolio Additional Estimates Statements was provided by DoHA as part of appropriately benchmarking the PHI rebate impact estimates.

Key assumptions

- The average rebate was based on the average cost (i.e. gross premium) of PHI which in turn was based on PHIAC data concerning total premium revenue and number of Single Equivalent Units (SEUs).
- Assumed growth in MLS revenue in the out years of 5% per annum.
 - With MLS thresholds indexed by wages growth, growth in the population of those singles and couples/ families liable for the MLS is expected to reflect growth in the broader taxpayer population.
 - The average MLS liability is expected to grow in a manner consistent with growth in underlying incomes for MLS purposes, which will be at a level that is comparable to wage growth.
 - The combined impact of these two effects leads to the assumed 5% per annum growth in additional MLS revenue.
- Indexation of income thresholds by wages growth (in accordance with MLS indexation) resulted in a starting point of \$75,000 / \$150,000 at 1 July 2010.
- Assumptions related to drop-out rates are outlined in a separate section below.

Methodology

The **PHI rebate and revenue impact estimates** were derived using the following methodology and assumptions:

- Treasury personal income tax microsimulation model was used to obtain data on the number of people estimated to have private health insurance at various ages and income categories (income in this instance is defined as income for Medicare levy surcharge purposes).
- The average rebate for singles and couples was calculated using average product cost data from the PHIAC Annual Report 2007-08 and applying a weighed average rebate of 32%.
- For each income, age and marital status category the number of people, average premium, average rebate per policy, and total rebate was calculated.
 - A benchmark estimate under current policy was calculated based on PHIAC data to benchmark the estimate of the number of people in the Treasury tax model.
- For each income, age and marital status category the average rebate per policy and total rebate outlay has been calculated after the proposed reduction of rebate by 10 percentage points for singles earning \$75,000 to \$90,000, 20 percentage points for singles earning \$90,000 to \$120,000 and to 0 per cent for singles earning over \$120,000. For couples/families, each of the relevant income thresholds is doubled.
 - There is also a small component of the estimated PHI rebate impact that comes about from behavioural change, where singles and couples drop their PHI cover (discussion of the numbers of singles and couples estimated to drop out is outlined below).

The **drop-out estimate** was derived using the following methodology and assumptions:

- Step 1 - estimate the number of people in the affected income ranges (tier 1) using Treasury personal income tax data, and benchmark this data with PHIAC data on private health insurance membership
 - For Tiers 2 and 3, as the percentage increase in MLS is very similar to the percentage increase in out-of-pocket costs for those facing a reduced PHI rebate (see Table 1 below for details), it was assumed that there would be no net change in PHI coverage for these two tiers.
- Step 2 - estimate the price elasticity for private health insurance demand.
 - Academic and empirical research suggests that private health insurance demand elasticity is around -0.3^1 , but this applies to all income categories. There is evidence that price elasticities are lower at higher income levels, so a price elasticity of -0.2 was used for Tier 1;
- Step 3 - estimate the proportional increase in cost of insurance to people in the affected income ranges after the relevant rebate reductions (i.e. for a person aged under 65, a 10 percentage point reduction in their PHI rebate increases their net PHI premium cost from 70 per cent of the gross premium to 80 per cent. This represents a 14.3 per cent increase in their net PHI outlay);

¹ Most recently, an August 2008 Access Economics report estimated a price elasticity -0.335 .

- Step 4 - estimate the drop out rate by multiplying price elasticity by the proportional increase in cost;
- Step 5 - estimate the number of singles and couples who will drop out by multiplying the drop out rate by the number of singles and couples within the affected income range; and
- Step 6 - estimate the total number of people who will drop out by factoring in the number of people in a couple and the average number of dependents/children in a couple/ family.
- The six steps outlined above were used to derive the estimate that around 25,000 individuals (6,500 singles and 5,500 couples and families) with PHI cover and earning between the MLS thresholds and \$90,000 (singles) and \$180,000 (couples) will opt out of PHI.
 - This represents a decrease in the number of people with PHI of around 0.26 per cent (a 0.3 per cent decrease in singles and a 0.25 per cent decrease in couples and families).

Flow-on from PHI drop-out estimate to increased MLS revenue

- As Step 1 assumes that only singles and couples/ families from Tier 1 would drop their PHI cover, it was subsequently assumed that the average income for those who drop out of PHI due to reduced level of rebate was \$80,000 for singles and \$160,000 for couples, reflecting that the income distribution for singles with incomes of between \$75,001 and \$90,000 (and for couples/ families with incomes of between \$150,001 and \$180,000) is not uniform across each range.
 - On this basis, it was assumed that the average MLS liability for each single who drops out of PHI would be \$800, and the average MLS liability for each couple who drops out of PHI would be \$1,600.

Table 1: Proportional increase in out-of-pocket costs for PHI and for MLS for singles and couples/families

| MLS income range* | % increase in out-of-pocket PHI cost** | % increase in out-of-pocket MLS cost |
|---|--|--------------------------------------|
| \$75,000 to \$90,000 (singles) \$150,000 to \$180,000 (couples) | 14.3% | 0% |
| \$90,000 to \$120,000 (singles) \$180,000 to \$240,000 (couples) | 28.6% | 25% |
| \$120,000 and over (singles) \$240,000 and over (couples) | 42.9% | 50% |

* Note that MLS income refers to income for Medicare levy surcharge purposes. \$75,000 for singles and \$150,000 for couples/ families are projected MLS thresholds for 2010-11.

** Out-of-pocket PHI costs increases based on currently receiving 30 per cent PHI rebate (i.e. applicable for those aged under 65).