

31 July 2003

Mr Elton Humphrey  
 Secretary  
 email: Medicare.Sen@aph.gov.au

Dear Mr Humphrey,

**re: Senate Inquiry Into Medicare: Clarification of Two Points**

During cross examination two questions were asked which I did not answer very well. The first was in the context of recent government policy and its effects. The second, at the end of the interview, concerned net and gross GP incomes.

With out the transcript I am repeating the question from memory:

**Question 1:** Why would the government implement reforms which would increase fees if this resulted in increased cost to government?

**Comment:** As with pharmaceutical copayments, the major effect of the reforms would be a transfer of expenditures from the public to the private sector and it is likely that this is the purpose of the reforms. To achieve this primary objective the government may be prepared to allow increased expenditures *in the private sector*. This is perfectly legitimate if social values emphasise liberal and libertarian objectives. Just as a social objective of bulk billing may justify higher expenditures, higher social expenditure is justified if the objective is the promotion of an ethic of self reliance. Of course it is desirable to achieve such an objective efficiently, so the efficiency of the reforms and of Australia's PHI may be challenged.

**Question 2:** Do the data refer to gross or net GP income?

**Comment:** The data I presented at the hearing are for gross fee income, with a dot indicating gross fee and PIP income/GP. The data indicate that gross fee income has risen at almost precisely the rate of average weekly earnings. Two points follow from this:

- (i) If it is argued that costs have risen disproportionately then the appropriate comparator is average weekly earnings (not CPI);
- (ii) If the increase in costs exceeds average weekly earnings then the appropriate and compensating increase in gross fees is not equal to cost inflation but to something less than this. (Conversely, if costs rise by less than AWE then the adjustment would be greater than cost inflation.) This is because the net income component of gross income has risen sufficiently to maintain income parity with community incomes and only the cost component is a problem and this is less than 100 percent of gross income. I have



illustrated the reason for this in the example in the table. Note that the figures are arbitrary to illustrate the arithmetic. They are unrelated to the medical sector.

In the first time period net income (in dollars) is equal to gross fees (\$100) less costs (\$50). In period 2 there are three cases. In each of these gross fee income rises with average weekly earnings and cost rise by \$10 to a value of \$60. In case 1 cost inflation exceeds AWE. Increasing gross income with AWE raises gross income to \$110. Net income does not change and there is a legitimate complaint by GPs. In case 2 gross fees are increased in line with costs, ie by 20 percent. This results in a net income of \$60, *that is by 20 percent which is double the increase in AWE.*

Example	AWE	Gross fee income (index)	- Costs	= Net Income	Index of relative net income <sup>1</sup>
First time period	100	100	- 50	= 50	100
Period 2 Case 1 Fee ↑ = AWE = 10% ↑ costs = 20%	110	110	- 60	= 50	91
Period 2 Case 1 Fee ↑ = Cost ↑ = 20%	110	120	- 60	= 60	109
Period 2 Case 3 Preservation of relative net income ↑ Cost = 20% ↑ Net income = 10%	110	115	- 60	= 55	100.0

Note <sup>1</sup>: Index =  $\left[ \frac{\text{net income}}{AWE} \right]_{\text{time 1}} \div \left[ \frac{\text{net income}}{AWE} \right]_{\text{time 2}}$

Case 3 illustrates the arithmetic when net income rises with AWE to \$55. **Note that the increase in gross fees is 15 percent, less than the increase in costs.**



Jeff Richardson  
 Professor and Director  
 Health Economics Unit  
 Monash University