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Consumer trends

Household spending on health products and services

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Inside:

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Consumer Trends is a regular series that analyses current Australian consumer spending preferences and patterns. The last issue was released in February 2007 and examined participation and spending trends in education and childcare. We publish separate reports twice yearly on retail sales (March and September) and new motor vehicle sales (February and August).

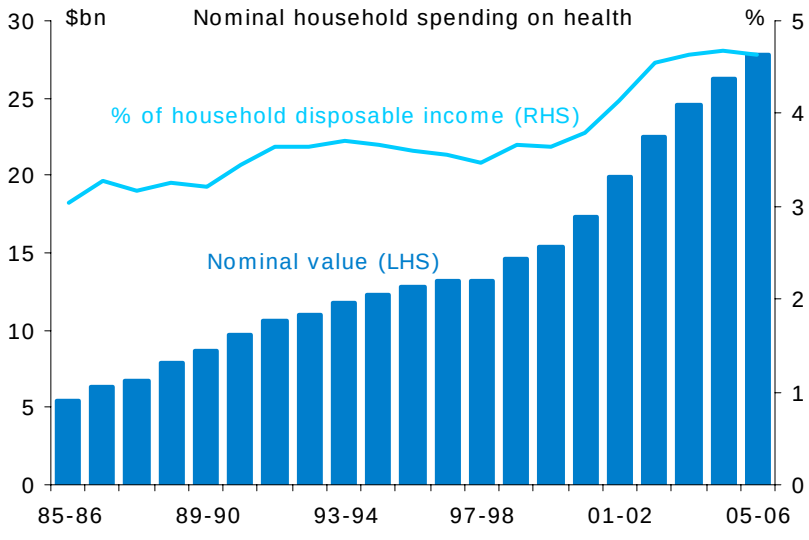
Key points

- Health has been one of the fastest growing components of household final consumption expenditure in recent years. While this partly reflects rising demand, sharp increases in the price of health products and services seem to have been a more important influence.
- Health price inflation has been overwhelmingly driven by technological change, such as the development of new drugs.
- With the ageing population adding to demand for health products and services, and technological advances likely to continue to drive price inflation in the sector, it is expected that spending on health will continue to increase strongly in coming years.

Consumer spending on health

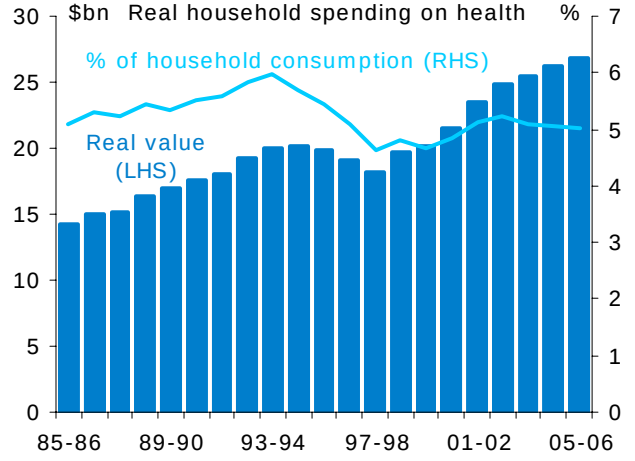
Australian consumers are becoming more health conscious. In 2005-06, households spent $27.8bn on health, up 5.8% on the previous year. Health is the fastest growing component of household final consumption expenditure, increasing at an average rate of 10.5% p.a. since 2000-01, compared with a rate of 6.3% for total household consumption more broadly. As a result, expenditure on health now accounts for 4.6% of household disposable income, up from 3.6% at the turn of the century.

Households are spending an increasing amount on health



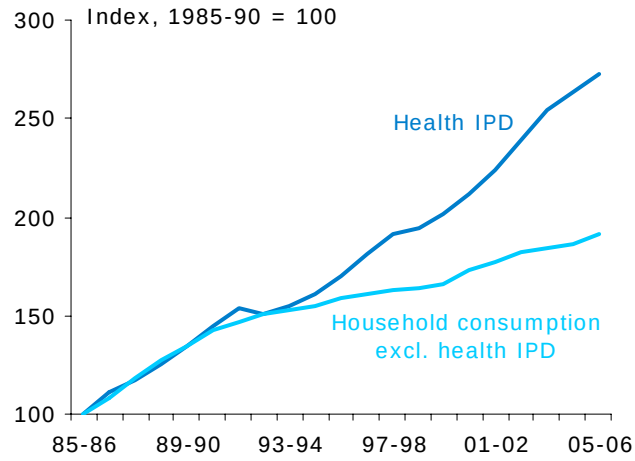
Source: Australian Bureau of Statistics

Part of the increase reflects the purchase of more health products and services...



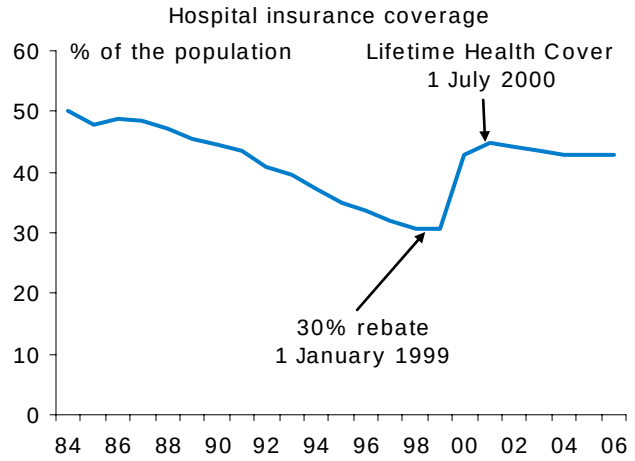
Source: Australian Bureau of Statistics

...but mostly it reflects strong growth in the cost of health



Note: An IPD (implicit price deflator) is a variable weight price index based on actual expenditure patterns.
Sources: Australian Bureau of Statistics and Economics@ANZ

Policy changes have arrested the downward trend in private health insurance coverage



Source: Private Health Insurance Administration Council

Of course, some increase in health expenditure is to be expected. Health is generally considered to be a 'luxury' good, so consumers are likely to spend a higher proportion of their incomes on it as incomes rise. And the ageing of the population also points to a higher health spend for a given level of population.

To this end, there is some evidence that consumers are purchasing more health products and services. However, the rate of growth in the *volume* of health consumption has been only gradual over time, and if anything, has been a little slower than other categories of household expenditure. Real spending on health has been steady at around 5% of total household consumption since 2001-02, and has actually fallen from almost 6% in the early 1990s.

Rather, it appears that the main reason we are spending more of our money on health is because its cost is increasing significantly faster than for other consumer goods and services. Since 1985-86 the price of health products and services consumed by households has increased over 270%. This compares with a 190% increase in the price of non-health consumer goods and services over the same period. Rapid price inflation for health products and services has been linked to significant quality improvements stemming from technological advances, such as the development of new drugs.

The remainder of this paper analyses trends amongst the major categories of consumer health expenditure.

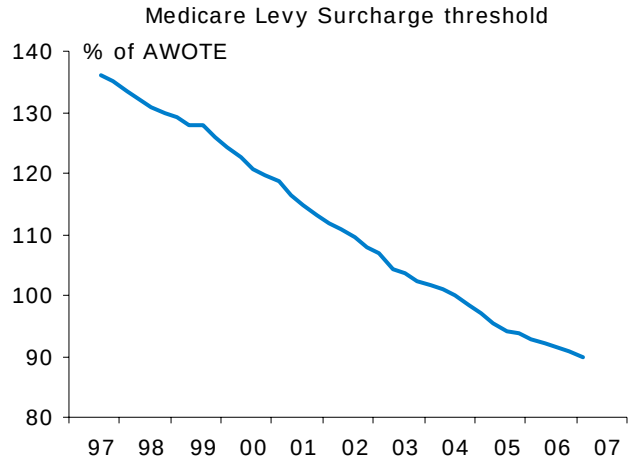
Private health insurance

Private health insurance is the single largest component of consumer health expenditure. In 2005-06, consumers paid $10.3bn in premiums, which accounted for almost 37% of total household expenditure on health. As with health spending more broadly, household expenditure on health insurance has grown strongly in recent years, increasing at an average rate of 9% per annum since 2001-02.

Part of this growth can be explained by an increased take-up of private health cover in recent years. Since 1999-2000, the proportion of the Australian population covered by some form of private hospital insurance has hovered between 43% and 45%, up sharply from a rate of 30.6% in 1998-99. In fact, prior to 1999-2000, hospital insurance coverage had been in trend decline since the early 1970s, when just under 80% of the population was covered by private hospital insurance.

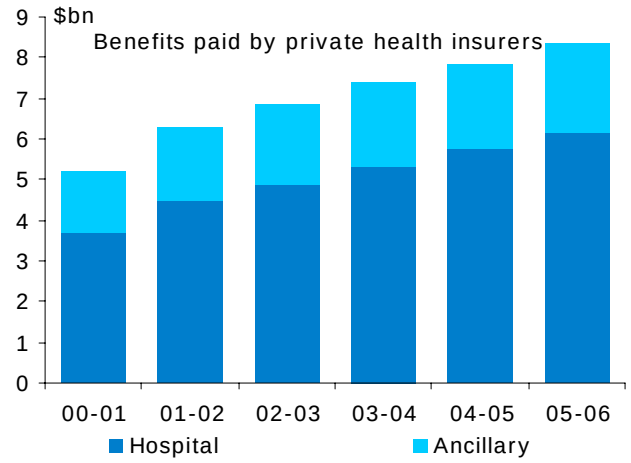
This downward trend was arrested by a number of policy initiatives instituted by the Coalition Government. Perhaps the most effective measure in terms of increasing take-up of hospital insurance was the 30% rebate on private health insurance premiums, introduced on 1 January 1999. The impact was stark. Within a year, the proportion of the population with private hospital cover increased

An increasing number of individuals now earn more than the Medicare Levy Surcharge threshold



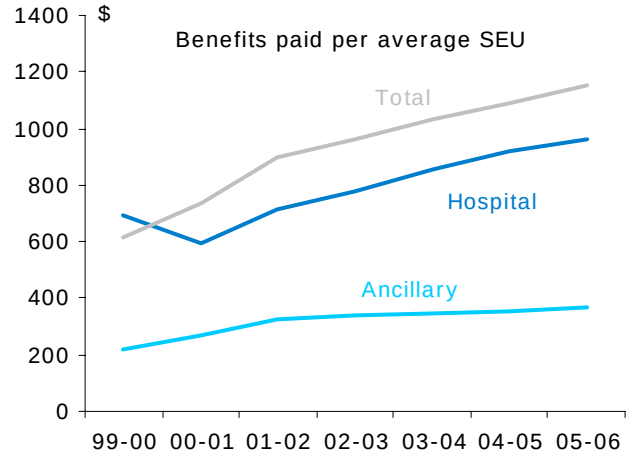
Sources: Australian Bureau of Statistics and Economics@ANZ

Rising health insurance premiums have been associated with rising benefits



Source: Private Health Insurance Administration Council

This in part reflects the rising cost of claims



Note: SEUs (Single Equivalent Units) are used to adjust for policies that cover more than one person.
Source: Private Health Insurance Administration Council

by over 12½ppts to 43% in 1999-2000, a level that had not been seen since 1990-91. The rebate has since been increased for older Australians, to 35% for those aged 65-69 and 40% for those aged 70 and older.

A second initiative – Lifetime Health Cover – which commenced on 1 July 2000, provides incentive to take out private hospital insurance at a younger age. It introduces a loading of 2% on top of the insurance premium for each year after the age of 30 individuals delay taking up cover, up to a maximum of a 70% loading. For example, someone who first takes out private hospital insurance at the age of 40 will pay a loading of 20% (10 years at 2% per annum) on top of their insurance premium.[1]

Finally, a policy which has received less attention, but is arguably exerting an increasing influence on private health insurance coverage, is the Medicare Levy Surcharge. This is a surcharge of 1% of taxable income (in addition to the 1.5% Medicare Levy) imposed on high income earners who do not have private health insurance. The threshold to be considered a 'high income earner' and therefore to be subject to the surcharge in the event you do not have private health cover is a taxable income of $50,000, which was equivalent to the threshold for the top marginal tax rate when the policy was introduced on 1 July 1997.[2]

While the threshold for the top marginal rate has since increased by $100,000 (or 200%), the threshold for the Medicare Levy Surcharge has remained at $50,000. As a result, the surcharge is now just 90% of full-time average weekly earnings – that is, less than the average full-time wage – compared with a level of 136% when it was introduced. This means that an increasing number of individuals are being dragged into the 'incentive net' cast by the policy, whereby it may make sense to take out private health insurance simply to avoid paying the surcharge.

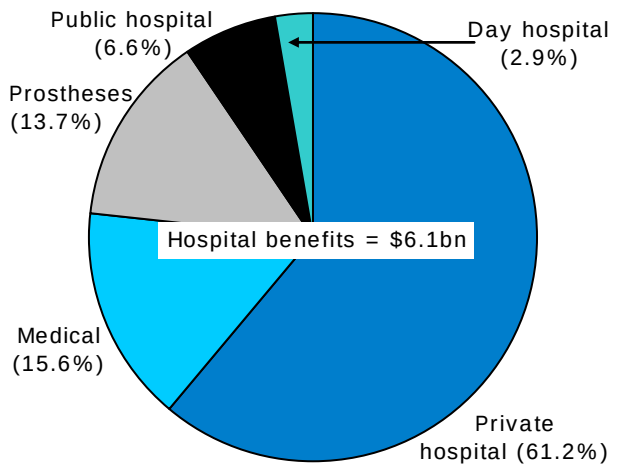
The remainder of the explanation for sharp increases in expenditure on private health insurance lay with rising premiums. Premiums increased by an average of 4.5% on 1 April this year, following increases of 5.7% in 2006 and 8% in 2005.

Sharp increases in premiums have been associated with similarly strong increases in benefits paid by private health insurance funds. In 2005-06, benefits paid by private health insurers totalled $8.4bn, up 6.6% from 2004-05. Since 2000-01, benefits paid have increased at an average rate of around 10% per annum.

[1] Following recent changes, any loading will be removed after 10 continuous years of private health cover.

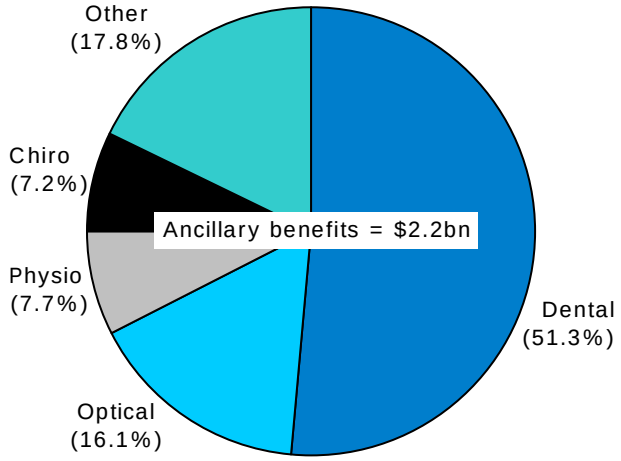
[2] The threshold is $100,000 for couples and families, increasing by $1,500 for each child after the first.

Hospital benefits paid by private health insurers, 2005-06



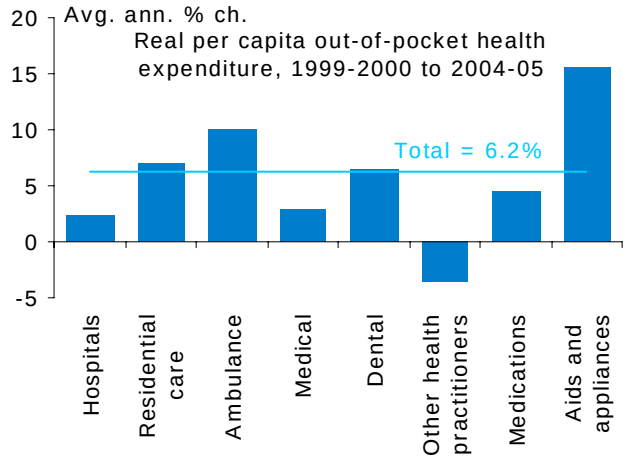
Source: Private Health Insurance Administration Council

Ancillary benefits paid by private health insurers, 2005-06



Source: Private Health Insurance Administration Council

Consumers are buying more health products and services, in addition to private health insurance



Sources: Australian Institute of Health and Welfare and Economics@ANZ

While growth in benefits is correlated with growth in coverage, described above, average benefits paid per member have increased significantly in recent years, indicating an increasing cost of claims. Hospital benefits per single equivalent unit (SEU) cost $964 in 2005-06, up 39% from $696 in 1999-2000.[3] Meanwhile, ancillary benefits per SEU were $367 per SEU in 2005-06, up 69% from $217 in 1999-2000.

The majority of private health insurance benefits – some $6.1bn or over 70% of total benefits in 2005-06 – are for hospital services. Within this, private hospital benefits accounted for over 60% of total hospital benefits, while medical and listed prostheses benefits were each around 15% of hospital benefits.

Ancillary benefits totalled $2.2bn or 27% of total private health insurance benefits in 2005-06. Over half of all ancillary benefits were for dental services, while optical (16.1%), physiotherapy (7.7%) and chiropractic (7.2%) were also significant.

Individual out-of-pocket health expenses

In addition to health insurance, consumers typically incur some level of out-of-pocket expenditure on health. In 2005-06, out-of-pocket health expenses amounted to $17.5bn, or 63% of total spending on health. Growth in individual out-of-pocket health expenses has slowed in recent years, from a peak of almost 25% in 2001-02 to 3.8% in 2005-06, although average annual growth since 2000-01 remains high, at almost 12%.

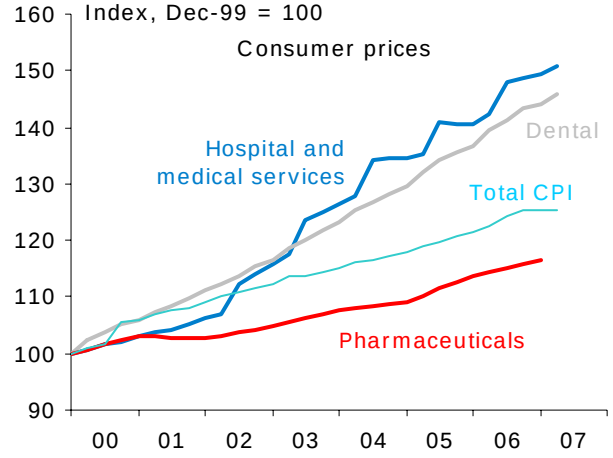
The most recent breakdown of out-of-pocket health expenditures by individuals is provided by the Australian Institute of Health and Welfare for 2004-05. The largest expenditures were on medications (27.8% of total out-of pocket expenditures), dental services (20.1%), aids and appliances (17.8%) and medical services (9.6%).

At least part of the increase in out-of pocket health expenditures reflects increased consumption of health products and services. In real terms, per capita expenditure on health has increased by 6.2% per annum since 1999-2000. Strongest growth has been in aids and appliances and ambulance services, which have increased by 15.5% and 10.1% per annum, respectively, over this period.

However, as is the case with private health insurance, rising prices explain a large part of the increase in individual out-of-pocket health expenses. The clearest evidence that consumers are paying more for their health – both private insurance and other health products and services – is provided by the CPI. Since the turn of the century, the price of

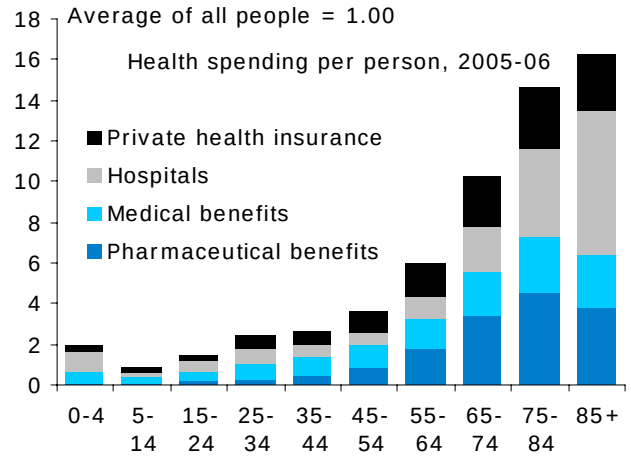
[3] Single equivalent units (SEUs) are used for analytical purposes to adjust for the existence of policies that cover more than one person.

Consumers are also paying more for health products and services



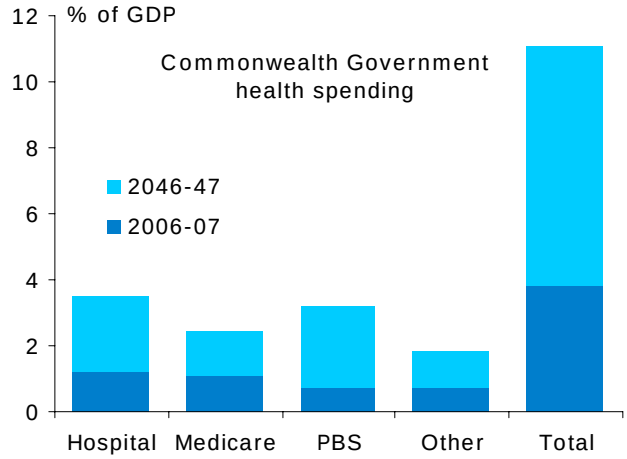
Sources: Australian Bureau of Statistics and Economics@ANZ

Health spending rises exponentially as people get older



Source: Australian Government, *Intergenerational Report 2007*

As a result, health care costs will rise substantially in coming years



Source: Australian Government, *Intergenerational Report 2007*

hospital and medical services has increased by 50.8%, roughly double the 25.7% increase in the CPI over the same period. Dental services have increased by a similar amount, up 45.7% since December 1999, while consumer prices for pharmaceuticals have increased more modestly, reflecting the operation of the Pharmaceutical Benefits Scheme.

Outlook and conclusions

Health has been one of the fastest growing components of household final consumption expenditure in recent years. While this partly reflects increasing demand as incomes rise and a larger proportion of the population moves into older age cohorts, sharp increases in the price of health products and services seem to have been a more important influence.

Health price inflation has been driven by technological change, such as the development of new drugs and wider use of more advanced (and expensive) diagnostic tools. In this respect, technology has been a double-edged sword: while consumers benefit from the improved quality of health care available as a result of technological advances, they also have to fork over more cash for the privilege.

Unfortunately, consumers are unlikely to get much respite from rising health care costs in coming years. The trend towards more expensive technologies in health care is unlikely to change in the foreseeable future. Furthermore, population ageing will impact demand for health more significantly in the coming decade as a greater proportion of the population graduates into age cohorts that use health services more intensively, a point reinforced in the Government's *Intergenerational Report*.

Against this backdrop, it seems certain that consumer spending on health will continue to increase strongly in coming years.

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