On "Consultation Document on Healthcare Reform"

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The document proposes six financing options to supplement the current system. Of the six options, out-of-pockets payments (option 2) and voluntary private health insurance (option 4) are amount to the *status quo*, leaving only four new ideas to supplement the current system. Hong Kong's healthcare system has two major challenges: (1) to increase the supply of healthcare to meet the increasing needs of an aging population and (2) to devise a viable financing system to pay for the growing needs.

After closely examining all six options, I come to the following observations:

1. None of the six options will subject the public hospital system to open competition with private hospitals and clinics. Without fair competition between the public and private hospitals, the supply of healthcare cannot grow to meet the increasing demand for healthcare as the population ages. In the current system, private hospitals can only cater to those who have means or those who have medical insurance, which is necessarily a small market. And the expansion of private hospitals has limited effect on relieving the current shortage of service in public hospitals because those who do not have sufficient insurance or means simply cannot afford the services at private hospitals. The social insurance option and the mandatory private insurance option in the proposal will pay the same amount for a given covered service from either public or private providers, but the providers will be allowed to charge different amounts for the same service. Because in the proposal public hospitals are still going to receive a large budget from the government, it is fair to assume that private hospitals will need to charge more than the public hospitals for the same service. Under this assumption, only limited number of patients will be willing or be able to pay more for the same service in private hospitals.

   Almost all countries which adopt a social healthcare system mandate that a single fee schedule be applied to all covered services whether they are provided by public or private hospitals and clinics. Providers, all getting paid the same amount for any given service, compete for patients based on quality of services. In addition, such a one-price system is less likely to evolve into a class system that I discuss below.

2. The public hospital system will be used as the last resort for many citizens without means under all proposed options. This will create a two-tier system, one for the haves and the other for the have-nots. Those who pay taxes and use private providers will become more reluctant to pay for a system that they rarely use, unlike the current situation in which 90% of inpatient services (in terms of the number of bed days) are delivered by public hospitals. This kind of two-tier or two-class system is not consistent with Hong Kong's aspiration to be a world city. In a progressive world city, all citizens should have similar access to healthcare.

3. Three options, the social healthcare insurance option, the mandatory private insurance option, and the personal healthcare reserve, are void of insurability problem, which is a major problem with the voluntary healthcare insurance option and the medical savings account option. In private insurance markets, insurers select good risks and avoid bad risks. As a result, those who need insurance may not be able to get insurance coverage. Hong Kong's current healthcare system treats access to reasonable healthcare as a right, not a privilege, as many advanced countries do. Any new system, to have a chance to be adopted, should not deviate from this fundamental principle.

Dollars and Cents

News reports seem to suggest that Hong Kong citizens are skeptical of all reform options, preferring the *status quo*. Their initial reaction is understandable. Under the current system, they get inpatient services almost for nothing as long as they do not mind the waiting and get outpatient services either from the public or private providers at reasonable costs. The four options that involve some forms of insurance all require that the working population make a contribution to the system in addition to the income taxes they are already paying. It is no wonder that they feel apprehended.

Below I use the 2004/5 domestic health accounts to illustrate that a well-structured compulsory medical insurance scheme need not impose additional financial burden on taxpayers.

In 2004/5, $37,179 million was spent on healthcare by the government, and $67,807 million in total was spent on healthcare (including$21,545 million in user fees, $5,168 million via employer insurance, and $3,284 million via private insurance). There are about 7 million residents in Hong Kong.

The average total expenditure per person per year = $67,807 million/7 million = $9,687
The government paid per person per year = $37,179 million /7 million = $5,311

If the government continues to spend $5,311 (adjusted for inflation in the future), an average citizen paid $4,376 (=$9,687 - $5,311) in 2004/5, i.e., $365 per month for the current level and quality of healthcare. It is reasonable therefore to assume that an average citizen should be able to get at least the current level and quality of healthcare by paying $365 per month in premium. If the system allows citizens to take their insurance to any service providers, they will enjoy better quality of service (due to competition) and less waiting (due to increases in healthcare supply). Such a system gives all citizens the same access to all healthcare providers in Hong Kong. A system like this will undoubtedly encourage private sectors to build hospitals and clinics to meet the growing demand. Thus, an average Hong Konger, by paying no more than they paid in 2004/5, can have access to at least the same quality of services in a much more timely manner.

To make the system work, obviously those who can pay need to pay more than $365 per month, so that the government can pay less than $5,311 per person per year, leaving money to pay premiums for those who cannot pay. Suppose 20% of the population cannot afford to pay the premium and thus needs the government to pay for them. The government needs to subsidize everybody $4,217 per year and require everybody to pay $5,470 per year in premium.[1] Those who cannot afford the premium should apply for

[1] Let X be the amount that the government budgets to subsidize the entire population so that ($37,179 million – X) can be used to pay insurance premium for the 20% population that cannot afford to pay. Assume that Hong Kong has 7 million in population, which leads to 1.4 million of them unable to pay premium on the mandatory insurance. Assume that the total expenditure per person per year is $9,687 as calculated in the main text. The insurance premium that the government pays for 1.4 million individuals is equal to ($37,179 million – X)/7 per person per year, which should be equal to the total expenditure minus the subsidy the whole population receives per person per year, i.e., 9,687 – (X/7). Writing in the form of equation gives (37,179 - X)/1.4 = 9687 – X/7. Solving for X yields $29,522 million, which is the total amount that the government subsidizes the entire population. Dividing $29,522 million by 7 million yields $4,217, the subsidy for each qualified Hong Konger per year. The insurance premium is the total expenditure minus the government subsidy for qualified individuals; i.e., $9,687-$4,217=$5,470.

assistance from the government. The above calculation assumes that 20% of the population gets the government to pay the entire premium for them. In reality, some of these individuals will be able to pay some. Even in the worst possible scenario, $5,470 per year is not far more than $4,376 per year that an average Hong Konger paid in user fees and insurance in 2004/5. Many employers are already paying private medical insurance for their employees. To these employers and other employers of fair sizes, it may be readily acceptable for them to pay a half of the insurance premium.

The fact of the matter is that the “average Hong Konger” does not exist. Some are healthy all their lives and so pay very little in user fees; others may have utilized the public system extensively for illnesses or accidents. Mandatory insurance averages out those who are more fortunate and those who are less fortunate in terms of medical needs. Nobody knows *ex ante* whether he/she is the lucky one or the less fortunate one. That is why we need risk pooling or insurance.

The above simplified calculations assume that the public hospitals and clinics do not get a budget from the government anymore—they get paid only for the services they render just as private hospitals and clinics based on a fee schedule. With fees fixed, public as well as private providers compete for patients by service quality. This arrangement will also encourage private sectors to build more hospitals and clinics as the demand for their services increase.

Mandatory Private Insurance or Social Insurance?

Mandatory private insurance and social insurance both involve a mandatory insurance coverage. But they differ in several critical aspects. First, social insurance requires that those who make more pay more (with a cap), as opposed to mandatory private insurance which requires the same premium from each person. Second, the proposed social insurance option requires only that the working population pay into the system, exempting those who do not work outside homes, as opposed to mandatory private insurance.

Social insurance requires a new government agency to administer the collection of contributions and verification and payments of claims. The role of private insurers in the social insurance scheme is limited to providing top-up insurance and other related insurance. The infrastructure and workforce that have already been in place to sell and serve private insurance policies will probably be dismantled after the implementation of social insurance. A mandatory private insurance scheme uses the existing private insurers to administer mandatory insurance for no or little profit and thus causes no side effect of upsetting the current medical insurance industry. Private insurers will make profits from top-up insurance and other related insurance.

The personal medical reserve option is a good idea but harder to accept by citizens. It necessarily requires those who can afford it to pay more into their own accounts—part of the money will be used to purchase medical insurance while the individuals are working and the other part is saved and accumulated over time for medical expenses after retirement. Instead of requiring citizens to set aside more specifically for medical purposes, the government can raise the tax exempt limit for mandatory provident fund contribution to encourage citizens to save more for their retirement needs, which includes medical expenses. Taking away the savings part, the personal medical reserve option is very similar to the mandatory private insurance option.

An issue common to the mandatory private insurance and social insurance is intergenerational subsidy. In the mandatory private insurance, the same premium is charged to the old and the young; in the social insurance, the same percentage of income is charged regardless of the worker's age. And data shows that medical expenses for individuals older than 55 are higher than those at younger ages (see Figure 1.2 in the consultation document). By paying the same premium, the young subsidizes the old. Since people grow old, they turn from being the party to subsidize to being the party to be subsidized as they age. Therefore, if the demographic structure remains stable in a long span of time, intergenerational subsidy does not pose a problem. However, if the society experiences a drastic change in demographic structure, intergenerational subsidy can be a problem. This problem can be alleviated with the government setting aside a fund to make up for shortage when the young population declines relative to the old population.

Recommendations

Any reform should address two major challenges that Hong Kong faces: (1) the supply of healthcare services to meet increasing demand from an aging population, and (2) the financing of such as system. As argued above, the current system supplemented with one of the six proposed options will simply not meet the challenges.

I recommend a mandatory private insurance system, not as a supplement but as the whole system. The system should at least have the following characteristics:

A. Every qualified Hong Konger pays the same insurance premium for the mandatory coverage. Those who cannot afford to pay should apply for government subsidy. The premium can be shared between the employer and the employee for working individuals.

B. A single fee schedule for covered services is set applicable to all service providers, private or public, so that the haves and have-nots have the same access to all service providers.

C. Money is allowed to follow patients. The public hospitals do not get a budget from the government anymore. They get paid only for the services they actually deliver. This levels the ground for competition between the public hospitals and private hospitals. Fair competition will encourage private sectors to build new hospitals and clinics to meet the increasing demand.

D. The collection of premiums and payments of claims are to be done by private insurers for little or no profit. This will avoid a massive buildup of government agencies and a massive destruction of the existing medical insurance industry.

I would also recommend that the tax exempt limit for mandatory provident fund be raised in order to encourage citizens to save more for expenses in retirement, which includes medical expenses.