

Hong Kong Health Care Reform: Unbundling Provision from Financing

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Hong Kong spends about 4.6% of GDP on health care with 53.8% financed by the government and the remaining by households in 2001.¹ Hong Kong's spending on health care either in dollar amount or as a percent of GDP is modest compared to other developed economies: U.S.'s 14.6% of GDP and Japan's 8.9% in 2002. And yet Hong Kong residents' life expectancy is 81.4 years, second only to Japan's 82. Hong Kong compares very favorably with its peers. So what is wrong with Hong Kong's health care system? Behind such achievements lie worrisome problems. The recurrent public health care expenditure is about HK\$30.3 billion, representing about 14% of the government's total public expenditure in 2004.² And the Hospital Authority, which manages 44 of Hong Kong's 56 hospitals, has been running huge deficits in recent years. The waiting time for low risk and high volume procedures can be as long as, for example, 15.8 months for cataract surgery in public hospitals in 2002. Cataract surgery costs HK\$68 in a public hospital and HK\$13,800 in Union Hospital in 2002.³ No wonder patients with modest financial means or without medical insurance would rather wait for 16 months than get an immediate treatment in a private hospital. Delayed treatment of cataract may not be a life-or-death matter; it nevertheless affects the patient's quality of life. In addition, more and more treatments and medications are not paid by public hospitals. On top of the current problems, Hong Kong, like most developed economies, is ageing. According to United Nation Development Programme, 9.8% of Hong Kong residents are 65 or above in 2003, and the percentage is expected to rise to 14.4% in 2015. The spending on health care will only increase as the population ages. The question is how to reform the current health care provision and financing system to meet the challenges lie ahead.

Health Care Provision and Economics

A health care system has at least two arms: service provision and financing, which interact with each other. The quantity and quality of health care have as much to do with financing

¹ This is the most recent data about Hong Kong available from the website of United Nation Development Programme.

² Data from "A Study on Health Care Financing and Feasibility of a Medical Savings Scheme in Hong Kong" distributed in July 2004 by Health Care Financing Study Group, Health, Welfare and Food Bureau.

³ Data from "Hong Kong's public health system turns to private sector for help," by Jane Parry, British Medical Journal, November 23 2002, p. 1194.

as to do with the education and training of health care professionals. The study, commissioned by the Hong Kong government, by the School of Public Health of Harvard University (hereafter the Harvard team) on Hong Kong's health care system reports that Hong Kong's system is equitable in that all income groups obtain the same quality of medical services. The same reports also point out that Hong Kong's health care provision is fragmented with focuses more on treatment than prevention. The waiting time (between the request for an appointment to the actual visit) for a treatment or surgery and the queuing time (between the arrival at the hospital and the visit) are too long, but the face interaction time with the physician is too short. As a result of long waiting and queuing time, 72% of outpatient services in Hong Kong are delivered by private clinics. In contrast, because of the cost differential between the public and private providers, 76% of inpatient services (and 92% of hospital bed time) are provided by public hospitals.⁴ These shortcomings can be improved via organizational changes as suggested by the Harvard team. They can also be improved through competition. It is strikingly unusual for Hong Kong, which boasts to be one of the most competitive economies in the world, to have fewer than 20 private hospitals. The cost differential shown above explains why private hospitals can only attract those with financial means and/or medical insurance. Health care financing can be devised to level the playing field for the private hospitals, and very likely fair competition will raise the quality of services.

Although health care provision is as important as financing, this essay focuses on the financing part of the system. Health Care Financing Study Group of Health, Welfare and Food Bureau issued its final report, A Study on Health Care Financing and Feasibility of a Medical Savings Scheme in Hong Kong, in July 2004. It reports that the Health Security Plan proposed by the Harvard team was not well received by the public because it involves inter-generation subsidy. The Study Group instead focuses on the study of the feasibility of the Singaporean style medical savings account. To weigh the pros and cons of major schemes out there, let's examine how health care differs from the appliances or cloths we buy.

Risk

Household health care expenditure is hard to budget with accuracy as opposed to expenditures on appliances and clothing. Illnesses and accidents can strike any time. If all households budget according to the worst case scenario, the economy as a whole will suffer from too little consumption and too little risky investment as a result of too much savings.

⁴ The figures are calculated based on Table 4.2 of "Improving Hong Kong's health care system, why and for whom?" by the Harvard team.

For example, in 2002 about 5% Americans incurred about half of U.S. medical costs.⁵ This is the nature of health care costs. Those unfortunate 5% could have been financially ruined if they did not have medical insurance or were not sufficiently wealthy. Uncertainty or risk is the first distinguishing characteristic of health care. Medical savings accounts only help households save for medical care but do not take advantage of the wonders of risk pooling. Singapore complements the medical savings accounts with Medishield to help pay catastrophic medical expenses and Medifund to subsidize the poor. When households' share of payments is too high, some (particularly low-income households) are likely to avoid preventative cares which seem unnecessary at the time but may be beneficial in the long run.

Social Justice

The second distinguishing characteristic is social justice. Hong Kong's current health care system reflects its value: health cares for all at little costs to users. That is, we feel all residents in Hong Kong are entitled to reasonable health care regardless of means. If we are to maintain that value, the system needs to keep its accessibility, affordability, and equitability and at the same time improves on financial sustainability and health care quality.

Risk Pooling and Adverse Selection

Risk pooling is the most effective way to deal with the kind of risk that health care is. Risk pooling requires that each in a group pay a small sum into a pool, from which the sick draws to pay for medical expenses. In theory, the more people in the pool the more likely the pool will stay solvent. This is insurance 101. Private or social insurance? There is increasing number of medical insurance policies marketed in Hong Kong. Most of the policies cover costs related to surgery and hospital stays with payment ceilings. These policies can at best supplement health care provided by the government. Although premiums look affordable to middle-class residents, they are likely to be too high for the coverage the insureds receive. Why? To answer this question, ask who are more likely to buy medical insurance. Those more likely to be sick or to incur medical costs! This is adverse selection. Insurance companies protect themselves from adverse selection by screening applicants for good risks, excluding pre-existing conditions, and jacking up premiums. Group medical insurance can mitigate adverse selection but still cannot solve the problem arising from the exclusion of pre-existing conditions. American style employment-based medical insurance exemplifies this problem. Exclusion of pre-existing conditions can discourage a person from switching to a new job after serious illness of self or family members because the new insurance policy may exclude the pre-existing condition. In sum, adverse selection (inherent in a private

⁵ Data from "Health Economics 101" by Paul Krugman, New York Times, November 14, 2005

insurance system) and exclusion of pre-existing conditions (as an anti-adverse-selection measure) may eventually make private medical insurance too expensive to most and unavailable to those who need it most.

Private or Social Health Insurance

Canada and Western European countries have varying forms of social insurance. The British and Canadian systems are financed with general taxations; and the French and German systems are financed with premiums jointly paid by employers and employees. Each system has its unique ways to allocate resources from the government to hospitals and clinics. The allocation of resources has important implications on health care quality. In this regard, the better-known Canadian system and the less-known Taiwan system stand out. Both systems allow money to follow patients. That is, service providers are reimbursed based on services delivered in accordance to a fixed fee schedule. They make profits by keeping patients and cutting costs, which not only encourages quality services but also cost containment. The Canadian primary health coverage includes dental surgery, and preventative care and medical treatments from primary care physicians as well as from hospitals. However, it does not include ordinary dental services, optometric services, and prescription-drug medication. Private health insurance, including coverage for home care and medications, can be purchased on an individual basis or group basis (provided by employers) to supplement the coverage provided by the government. Although the Canadian Health Act prohibits private clinics from providing primary health care, private clinics provide them nonetheless. The Canadian financing scheme encourages competition among public providers but does little to encourage the competition of private providers with public providers. The Taiwan System, on the other hand, allows public and private providers alike to provide primary health care, truly allowing money to follow the patients. Taiwan also allows private health insurers to provide supplementary health insurance.

The Canadian and Taiwan's single-payer system saves on administration costs and supplies and medicine purchased in bulk quantities by the government. Canada spends about 9.5% on health care with 75% from public funding, and Taiwan spends about 5.9% on health care with 66% from public funding. Both systems boast universal coverage to their respective citizens without regard to their financial means.

The U.S. is the only industrial country which relies on private insurance (primarily employment-based group insurance) to cover all but the poor and the senior. Private group medical insurance varies in coverage and limits. As a result, both health care providers and medical insurance companies incur substantial sums to sort out what is covered and how

much a plan pays. Some estimation puts administration costs at 30% of the total privately insured medical costs in the U.S. This is one of the reasons that the Americans spend most on health care and yet have failed to produce top health results, not to mention the 45 million Americans who are not poor but cannot afford health insurance. However, this does not mean that private insurance has no place in health care financing in Hong Kong.

Morale Hazard and Frauds

Insurance, private or social, always invites morale hazard problems and frauds. It is easy to see how health care can be abused whether the private insurer or government pays the bills. Won't you pick the most expensive car in the showroom if someone else is paying the bill? When given the choice of a brandname drug or a generic equivalent, when given the choice of seeing a doctor or taking a bed rest for a common cold, the choices are more likely to be the more expensive options if either the government or the insurer is paying. These are typical morale hazard problems. The Federal Bureau of Investigation (FBI) in the U.S. has since 2005 been investigating medical insurance frauds that involve close to 100 surgery centers in California. The fraudulent claims to health insurers are estimated to be at least US\$500 million.⁶ Those surgery centers use middlepersons to recruit "clients" who have health insurance. These clients get unnecessary examinations, such as colonoscopy, in exchange for a few hundred dollars in cash or plastic surgery. The unnecessary examinations are paid by insurers. This case involves quite a number of insurers. With all their incentives for profits they failed to detect the fraudulent claims sooner, let alone in a social insurance system where the government is the payer. A sound system of health care should therefore provide incentives to mitigate these problems. A medical savings scheme will fare well in this regard. Proponents in the U.S. argue that when people pay with their own money they become sharp consumers and are more motivated to adopt healthy lifestyle. Opponents fear that people may get too smart about their money to get preventative care. Recent results on a limited experiment with such accounts in the U.S. are mixed. Opponents' concerns have been borne out; and the virtues of such accounts are appreciated by some users.⁷

Advances in Life Science and Medical Technology

Between 1970 and 2002 health care spending increases by 5.5% per year in Ireland, about 4.5% in Japan and the U.S., and less than 3.5% in Canada, all in real terms.⁸ The increases

⁶ From "Huge Medical Insurance Scam Alleged" aired on "Primetime" of the American Broadcasting Corporation on March 18, 2005

⁷ From "Prognosis is Mixed for Health Savings" by Milt Freudenheim, New York Times, January 26, 2006

⁸ OECD Health Data 2004

are astonishing and seem not particularly related to the way health care is financed. There must be a common factor driving the ever increasing costs. Most health economists believe the advancement of medical technology and treatments to be the main culprit. CT and MRI scans, for example, are regularly ordered for in-depth examinations. The costs would not have been incurred before their invention but are now. Another culprit is the changing expectations of patients. Patients have come to expect their physicians to perfectly diagnose and treat their illnesses. Physicians in efforts to meet those expectations and to avoid lawsuits for malpractices are more than willing to oblige. After all, someone other than the patient and physician are footing the bills. This is particularly true in the U.S.

Isn't medical advancement a good thing? It has contributed greatly to the rising life expectancy through the reduction of infant mortality rates and deaths from cardiovascular diseases and cancers, just to name a few. The human benefits are obvious while the economic benefits are not quite as obvious. Extensive studies are needed before the question can be answered reliably. Suffice it to say that health care costs are expected to rise even without ageing populations and inefficiencies in health care financing.

Characteristics of an Efficient Health Care System

To summarize, an efficient health care provision system must

- integrate preventive care (including promotion of healthy lifestyle), medical treatments, and long-term care
- improve the contact time between physicians and patients
- provide timely and effective health care
- encourage continuing education of physicians

An efficient health care financing system must

- encourage patients to seek necessary health care, particularly preventive care
- protect patients from financial ruins
- ensure all residents affordable and accessible health care
- reduce morale hazard and frauds
- enhance bargaining power of health care payers against suppliers
- discourage unnecessary usages of health care
- encourage healthy competition among health care providers

A System for Hong Kong

What we know about Hong Kong's current system are:

- long waiting for some of non-emergent surgeries and treatments provided by public hospitals
- Hospital Authority running large budgetary deficits
- Hong Kong residents already paying 72% of the costs of outpatient care
- Public hospitals providing and financing about 76% of inpatient services

Unbundling Financing and Service Provision

Hong Kong's public spending on health care is mostly through its public hospital systems. That is, public financing and service provision are bundled: if you want the government to pay for the services you must use a public hospital. Unbundling financing and service provision is likely to lead to improvement in quality of care and quantity of care provision by stimulating private participation and competition among private and public providers. Needless to say, safeguard measures must be taken to prevent competition from eroding quality of care.

Should this unbundling take the form of private or social insurance? Private insurance amounts to a total shift of financing to either individuals or employers. With 17% of Hong Kong's households living in poverty⁹ and those who make less than HK\$5,000 per month on average saving nothing¹⁰, it is infeasible to shift all health care burdens to individuals. Shifting the burden to employers plus employees amounts to a radical change from the current system, which requires not only enormous political will but also traumatic changes. A more feasible way is to use the current public financing differently by giving the power of choosing care providers, private or public, to patients. Like Canada's single-payer system, the government pays the bills for covered care. Unlike the Canadian system, private providers should be allowed to provide all types of services, instead of just specialty care as in Canada.

As put forth above, insurance of any type fosters morale hazard, frauds, and abuse of health care. Deductibles and co-payments can be built in the system, with an annual out-of-pocket payment from the patient capped at a certain level. Deductibles and co-payments help mitigate those named problems. If a patient is to pay 10% or 20% of the services used he/she would be less likely to use unnecessary services. At the same time, the annual cap to the patient's payment for health care protects him/her from financial hardship or ruin.

⁹ From "Poverty in Hong Kong" published by The Hong Kong Council of Social Service in August 2005

¹⁰ From "A Study on Health Care Financing and Feasibility of a Medical Savings Scheme in Hong Kong" by Health Care Financing Study Group, Health, Welfare and Food Bureau published in July 2004

Social insurance coverage is inevitably limited. This is where private insurance comes in--as supplement to social insurance. As supplementary insurance, either individual or group insurance will be affordable to most because the primary risk is borne by the public through social insurance. Many employers in Hong Kong are already providing private insurance to their employees. The change will only strengthen the coverage for their employees at lower costs.

Medical savings account can be used to help people pay for supplementary health insurance, deductibles, and co-payments. For those who make too little to save any, the government needs to step in either through direct payments to health care providers or through contribution to the medical savings accounts of those in need.

Concluding Remarks

Hong Kong's health care system has provided affordable, accessible, and equitable services to its residents. Any reform should strive to maintain those achievements. The author recommends that Hong Kong reform its system by unbundling service provision from financing, allowing patients to have the power to choose service providers. The current public spending can be used to pay for universal coverage for all qualified residents with an annual deductible, co-payments, and out-of-pocket cap. An individual or family medical savings account can be established to save for medical expenses not covered or paid by the social insurance, and for supplementary health insurance.

In addition, medical insurance varies in coverage and limits, both health care providers and medical insurance companies incur substantial sums to sort out what is covered and how much a plan pays. Some estimation puts administration costs at 30% of the total privately insured medical costs in the U.S. This is one of the reasons that the Americans spend most on health care and yet have failed to produce top health results, not to mention the 45 million Americans without health insurance. However, this does not mean that private insurance has no place in health care financing in Hong Kong. The amount of annual deductibles, the percentage of co-payment, and the services covered by social insurance can only be determined after thorough studies and estimations. The discussion here has been limited to medical care.¹¹ It has not touched upon long-term care (for those who are incapacitated for daily living) and disability income protection (for those who are incapacitated for making a living). These issues may confront us sooner rather than later.

¹¹ In a strict sense, the term "health care" encompasses medical care, long-term care, and disability income protection.

