THE CENTRE FOR INDEPENDENT STUDIES

Fiscal Fiction: The Real Medicare Levy

Jeremy Sammut

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RR14 Jeremy Sammut, *Medi-Value: health insurance and service innovation in Australia - implications for the future of Medicare* (2016).

RR21 Jeremy Sammut, Peta Seaton, Gerald Thomas, *Medi-Vation: 'Health Innovation Communities' for Medicare Payment and Service Reform* (2016).

Executive Summary

- The Turnbull Government is reportedly considering increasing the Medicare Levy to part fund the roll-out of the National Disability Insurance Scheme (NDIS).
- However, the Medicare Levy is a fiscal fiction — the levy revenue accounts for a mere fraction of government spending on Medicare.
- This report sets the record straight about the true cost of health to taxpayers by calculating the 'real' Medicare Levy — the actual amount and rate of income tax that funds Medicare.
- In 2013-14, the 1.5% Medicare Levy collected just $10.3 billion in revenue, and covered less than 15% of the $71 billion cost of Medicare. The total cost of Medicare actually accounted for almost 44% of total income tax revenue.
- In order to raise the full amount of income tax to meet the full cost of Medicare, the rate charged to income earners would be 10.4% — rather than the 'fake' 1.5% rate.
- The Medicare Levy was increased from 1.5% of personal taxable income to 2% from July 2014 to help pay for the NDIS.
- The 2% 'Medicare and Disability Care Australia Levy' raised $14.6 billion in 2014–15, with the amount identified for Medicare being $10.75 billion. As this covered just 14.3% of the $74.7 billion cost of Medicare, and because the full cost of Medicare accounted for 42% of total income tax, the 'real' Medicare Levy remained 10.4%.
- In reality, many taxpayers effectively paid a '10% levy' on their incomes in 2014-15 and contributed a significant real dollar amount in income tax to fund the cost of Medicare. Single individuals earning the modest amounts of $50, 000, $75,000, and $100,000 paid $5,200, $7,800, and $10, 400 in income tax respectively to pay for Medicare.
- The fact that taxpayers are paying almost seven times the official Medicare Levy to pay for Medicare deserves to be better understood by the nine million income earners paying the levy each year: this is essential to have an informed and honest debate about the speculation the levy may be hiked again in the May 2017 Budget.
- An additional NDIS-related increase to the Medicare Levy (of say another 0.5%) will not merely increase the levy to 2.5% of personal income: it will actually push the real levy rate to beyond 11% of taxable income — higher than the 10% GST on the purchases of goods and services.

Introduction: Budget Rumours

The Turnbull Government is reportedly considering increasing the Medicare Levy in the May 2017 Federal Budget to part-fund the roll-out of the National Disability Insurance Scheme (NDIS) from 2018.[1] The pre-Budget speculation about a new tax rise follows the Gillard Government's decision in the May 2013 Budget to increase the Medicare Levy from 1.5% of personal taxable income to 2% from July 2014 to help pay for the NDIS.[2]

The Medicare Levy is paid by all income earners (with exemptions for the low-incomed and aged pensioners) to provide access to healthcare regardless of income. Under Medicare — Australia's national universal, taxpayer-funded health scheme — all Australians are entitled to receive free or subsidised access to GP and other medical services, prescription medications, and public hospital care. These three major publicly-funded entitlement programs – the Medical Benefits Scheme (MBS), the Pharmaceuticals Benefits Scheme (PBS), and free treatment in public hospitals – account for more than two-thirds of the $105 billion spent by Australian governments on health in 2013-14.*

The Medicare Levy was established and set at 1% of personal taxable income when the Hawke Government introduced Medicare in 1984. It was raised to 1.25% in December 1986, and then, under the Keating Government, to 1.4% of income from July 1993, and to 1.5% from July 1995. In July 1997, the Howard Government introduced a 1% Medicare Levy surcharge for higher income earners who did not take out private health insurance, which has since been increased to 1.25% and 1.5% for 'very high' earners whose incomes exceed set thresholds.[3]

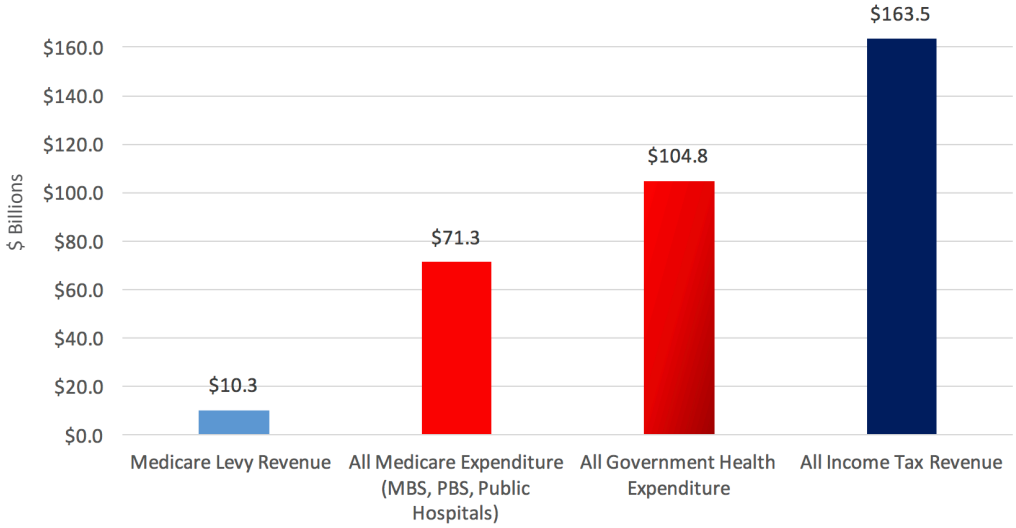
However, the Medicare Levy is, and always has been, a fiscal fiction. The revenue raised by the levy is not 'hypothecated' — dedicated specifically to fund Medicare — but goes into general government revenue. Moreover, the amount of revenue raised by the levy accounts for a mere fraction of government spending on health. Nevertheless, by fostering the myth that Medicare costs taxpayers only a small percentage of their incomes, the levy creates the false impression that Medicare is a low cost and affordable government program.

This report sets the record straight by telling the truth about the Medicare Levy. The details provided here about the 'real' Medicare Levy — the actual proportions and rate of income tax that funds Medicare entitlements and other health-related government expenditure — deserves to be well known by the more than nine million hard-working Australian taxpayers who pay the levy each year.[4]

A better understanding of the true cost of health to taxpayers is essential in order to have an informed and honest debate about any plan to hike taxes by further increasing the Medicare Levy. In reality, as shown here, the 'real' Medicare Levy rate being paid on income by Australians to fund health exceeds the 10% Goods and Services Tax (GST). Rather than lift the 'real' Medicare Levy even higher, the alternative approach recommended here is to seek efficiencies in health spending by undertaking reforms that can produce substantial savings and be used for other purposes such as funding the NDIS.

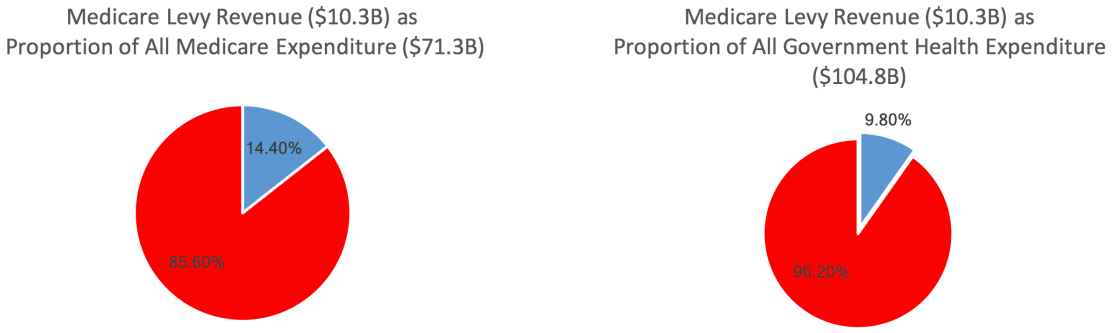
* While the MBS, PBS, and 'free' public hospitals are separate programs with separate funding streams, they collectively constitute the 'Medicare' scheme that parallels the UK's 'free and universal' National Health Service (NHS): the comprehensive access to healthcare services hereby offered obviate the need for private health except by choice (or to avoid Medicare Levy Surcharge penalties), and enables consumers to rely on taxpayer-funded services covering the major categories of healthcare needs.

Figure 1: The Medicare Levy Myth



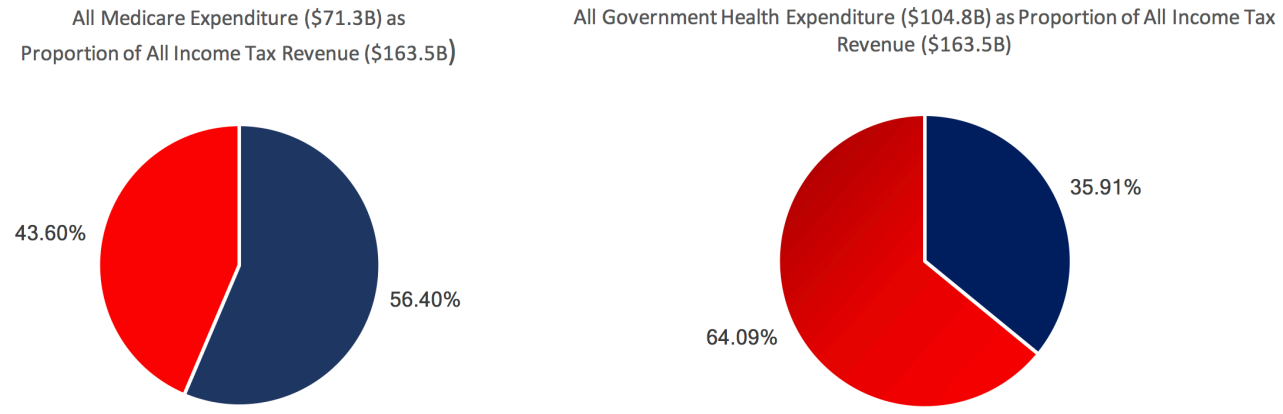
Source: Australian Institute of Health and Welfare, Australian Health Expenditure 2013–14, (AIHW: Canberra, 2015); Australian Government, Final Budget Outcome 2013–14, (Commonwealth of Australia: Canberra, 2014).

Figure 2: The Fake Medicare Levy



Source: Australian Institute of Health and Welfare, Australian Health Expenditure 2013–14, (AIHW: Canberra, 2015); Australian Government, Final Budget Outcome 2013–14, (Commonwealth of Australia: Canberra, 2014).

Figure 3: The Real Cost of Health



Source: Australian Institute of Health and Welfare, Australian Health Expenditure 2013–14, (AIHW: Canberra, 2015); Australian Government, Final Budget Outcome 2013–14, (Commonwealth of Australia: Canberra, 2014).

Health Taxing and Spending 2013–14

In 2013–14 — the year prior to the NDIS-related increase of 0.5% — the Medicare Levy was 1.5% (plus the Medicare Levy Surcharge where applicable) and the total revenue collected was $10.3 billion (not including the relatively miniscule amount collected by the Medicare Levy surcharge of $232 million according to the Australian Taxation Office's Tax Statistics).[5] By comparison (see Figure 1), 'All Medicare Expenditure' (federal government spending on the MBS and PBS, and combined federal, state and territory spending on public hospitals) topped $71 billion.**

The revenue raised by the Medicare Levy thus covered only a fraction — less than 15% — of total Medicare expenditure (see Figure 2). As a proportion of 'All Government Health Expenditure' (including All Medicare Expenditure), the Medicare Levy raised under one-tenth of the cost of the health spending.

The total amount of personal income tax revenue (including the Medicare Levy) collected in 2013–14 was $163.5 billion. As Figure 3 shows, as a proportion of total income tax, government spending on Medicare entitlements represented almost 44% of income tax revenue. This represents the real share of income tax - all things being equal, and as opposed to the fake Medicare Levy - that paid for health spending in 2013-14.

Based on these figures, we can estimate the 'real' Medicare Levy — the actual rate of income tax specifically imposed as the Medicare Levy in order to pay for Medicare. This represents the 'real' levy that would apply if the principle underpinning the Medicare Levy was strictly and accurately applied, and the levy was explicitly set at the rate adequate to meet the full cost of all the 'free' or heavily subsidised health care provided under the MBS, the PBS, and in 'free' public hospitals.

The actual cost of Medicare was equal to almost 44% of total income tax revenue, and the Medicare Levy raised only sufficient revenue ($10.3 billion) to pay for under 15% of Medicare expenditure. The 'real' Medicare Levy can therefore be calculated (assuming revenue increases in a linear fashion) by multiplying the 'fake' 1.5% figure until it is equal to the rate required to collect sufficient income tax revenue to fund the full $71.3 billion cost of Medicare.

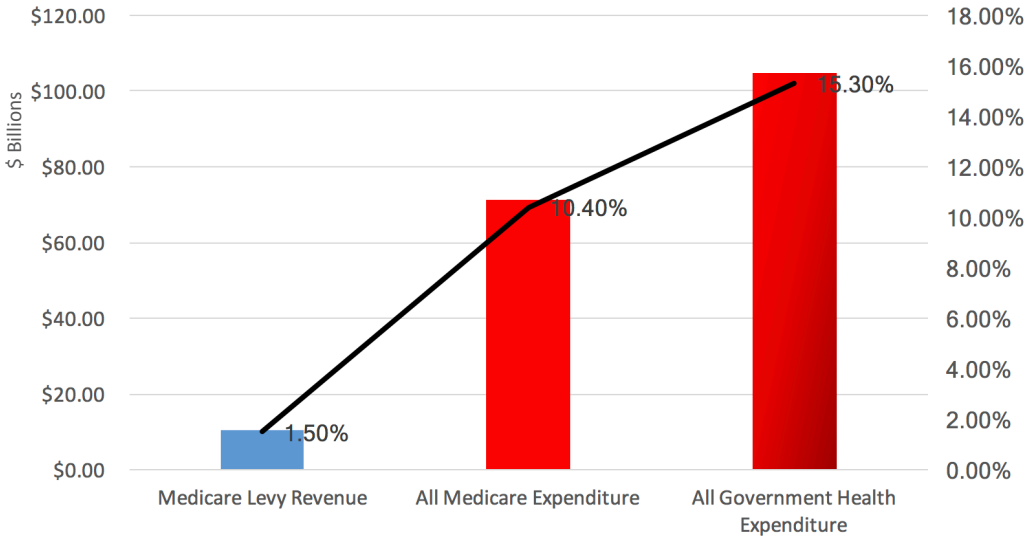
** This figure includes state government spending on public hospitals funded by 'own source' revenue. Inclusion in the total cost of Medicare is justified on the following grounds. Since the start of Medicare in 1984, and under what were originally known as the 'Medicare Agreements', state governments have received federal funding for health on the condition that public hospitals care is 'free' at point of consumption without user charges applying. Using the financial power of the Commonwealth to force the states to agree to these conditions — and contribute the remaining cost of 'free' hospital care — is another example of the way the Medicare Levy myth obscures the real cost of Medicare. Inclusion of state spending on public hospitals is justified for the purposes here of calculating the 'real' Medicare Levy, in order to establish what Medicare would really cost taxpayers if the 'universalist' principles purportedly underpinning the scheme and the levy were strictly and accurately applied: each paying according to their income so that each can receive healthcare according to their needs.

As Figure 4 shows, to raise the full amount of income tax revenue to meet the cost of all Medicare expenditure in 2013–14 via the Medicare Levy, the rate charged to income earners would be 10.4% — rather than the official 1.5%. This is to say that, in reality, taxpayers effectively paid a '10% levy' on their incomes in 2013–14 in terms of the real amount of income tax revenue consumed by Medicare. With regards to all government health expenditure, the 'real' Medicare Levy was more than 15% of personal taxable income.

The 2% 'Medicare and Disability Care Australia Levy' raised around $15 billion in 2015–16,[6] three-quarters of which is earmarked for Medicare, with the remaining quarter to part-fund the NDIS.[7] Health expenditure data for 2015–16 is not yet available. In 2014–15, the 2% Medicare Levy raised $14.6 billion — with the amount identified for Medicare being $10.75 billion (minus the relatively miniscule $219 million collected by the Medicare Levy Surcharge).[8] This covered just 14.3% of the $74.7 billion cost of all Medicare expenditure in 2014-15, with that expenditure accounting for 42% of all income tax revenue. Hence, the 'real' Medicare Levy in 2014–15 remained 10.4% (Figure 5) — plus the 0.5 Disability Care Australia levy.

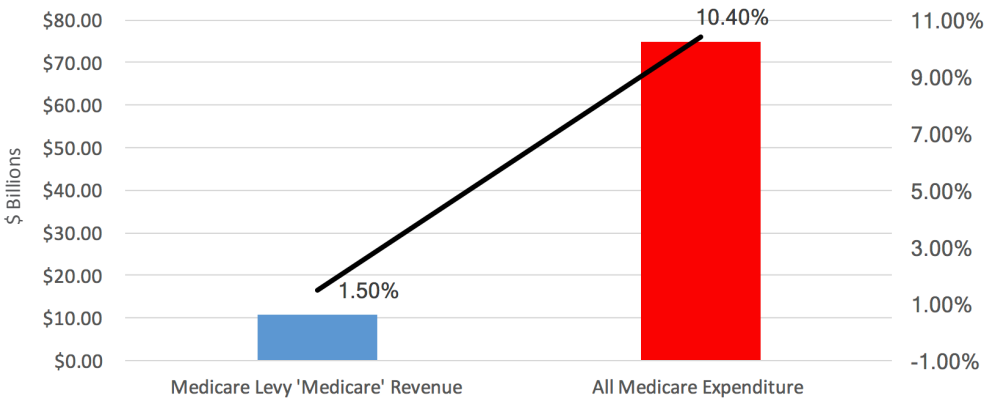
What health spending really costs Australian taxpayers is alarming when expressed as the 'real' Medicare Levy rates of 10% and 15%. As significant is the real dollar value of 'real' Medicare Levy.

Figure 4: The 'Real' Medicare Levy (%) 2013–14



Source: Australian Institute of Health and Welfare, Australian Health Expenditure 2013–14, (AIHW: Canberra, 2015); Australian Government, Final Budget Outcome 2013–14, (Commonwealth of Australia: Canberra, 2014).

Figure 5: The 'Real' Medicare Levy (%) 2014–15

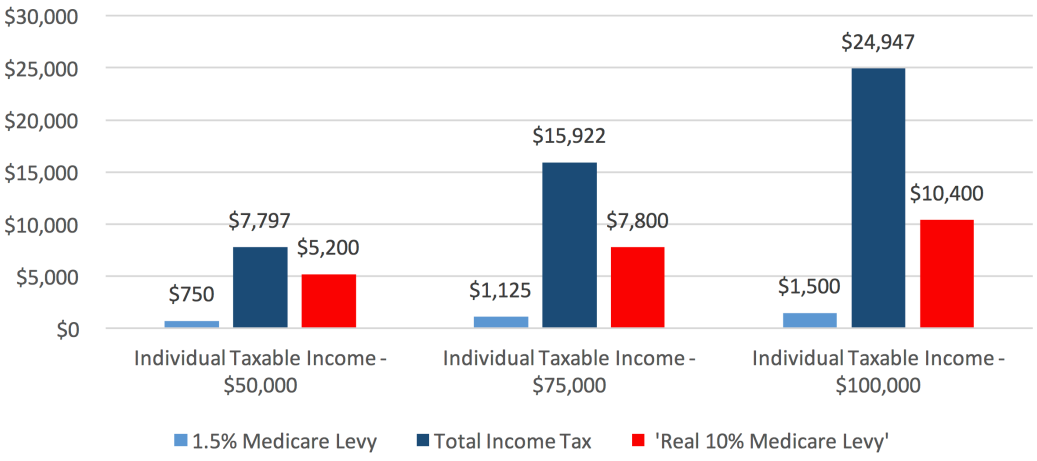


Source: Australian Institute of Health and Welfare, Australian Health Expenditure 2014–15, (AIHW: Canberra, 2015); Australian Government, Final Budget Outcome 2014-15, (Commonwealth of Australia: Canberra, 2014).

When this is calculated based on individual personal taxable income, it emerges that even taxpayers with relatively modest incomes are paying large amounts of income tax to pay for the cost of Medicare— which is to say the cost of the health services that average taxpayers are most likely to use.

Figure 6 shows the 'fake' and 'real' Medicare Levy amounts paid by single individuals with taxable incomes of $50, 000, $75,000, and $100,000. The 1.5% Medicare Levy paid by individuals earning these amounts was $750, $1,125, and $1,500 respectively. The total amount of income tax (excluding the Medicare Levy) they paid was $7,797, $15,922, and $24,947. The amount of income tax that paid for the cost of Medicare — the 'real 10% Medicare Levy' — was $5,200, $7,800, and $10, 400.

Figure 6: The 'Real' Medicare Levy ($) by Individual Taxable Income



Source: ATO Income Tax and Medicare Levy Calculators. https://www.ato.gov.au/Calculators-and-tools/?sorttype=SortByTopic

Implications

When an NDIS-related increase in the Medicare Levy was proposed in 2013, the 'real' Medicare Levy of 10% (rather than the fake official 1.5% rate) should have been cited. The fact that taxpayers were effectively paying almost seven times the official rate to pay for Medicare puts a very different complexion on the 0.5% increase introduced in 2014 — and on the speculation the levy may be hiked again to help fund the NDIS.

There have been a number of recent calls to raise the Medicare Levy. These include: Senator Nick Xenophon's proposal for a 0.25–0.5% rise to fund the NDIS;[9] the Queensland and Victorian state governments' demand for a 2% rise to fund public hospital services;[10] and the Australian Council of Social Services pre-Budget submission calling for higher taxes on the 'rich' by forcing all higher income earners to pay the Medicare Levy Surcharge — which would increase the levy to 3%, 3.25% or 3.5% depending on income level. [11]

The estimated cost of the NDIS in its first full year of operation in 2020 is now $22 billion, which is $7 billion more than the $15 billion cost estimated by the Productivity Commission in 2012. This includes a $4.1 billion 'funding gap' in 2020, which represents the difference between the full cost of the NDIS and the increase in the Medicare Levy and other targeted savings identified across other programs by the Gillard Government to offset the cost of the NDIS.[12]

Based on the real '10% levy', an additional NDIS-related increase to the Medicare Levy — of say another 0.5% that would raise an estimated $4 billion and virtually close the NDIS funding gap in 2020[13] — will not, as claimed, merely increase the levy to 2.5% of personal income. It will actually push the total real levy rate (based on 2014–15 figures) to beyond 11% of taxable income — collecting more than $11 out of every $100 dollars of personal income earned — a rate higher than the 10% GST on the purchases of goods and services.

It might be argued that increasing the tax burden is nevertheless justified in order to fund a program as important as the NDIS, which aims to ensure that Australians with profound disabilities receive the care and support services they need. The point, however, is that Australians already pay a very large amount of tax to fund Medicare — even though they think they do not because of the fake levy, and are therefore misled into thinking the scheme is good value.

Rather than take the lazy option of further tax hikes, there is considerable scope for health reforms to yield large savings. These savings could be used to cut tax and increase disposable incomes. Or they could be used to fund in an affordable way other areas of government expenditure, such as the NDIS, without the need for tax increases such as raising the Medicare Levy.

Conservative estimates made by the consulting firm Port Jackson Partners suggest that 11% of the total national health spend (public and private) is wasted every year.[14] As the Productivity Commission has concluded, the level of inefficiency is linked to structural problems in the health system, and principally concern the over-reliance on 'fee-for-service' payments systems for doctors and hospitals that reward 'activity', irrespective of results, rather than cost-effective health outcomes for patients.[15]

These problems mean — as flagged by 2015 OECD review of the Australian health system — that too much is spent on some kinds of healthcare and too little on other kinds of healthcare that could produce better and lower cost results.[16] 'Integrated' healthcare services that better coordinated primary and hospital care, and more effectively managed chronic illness, could keep patients well and minimise the use of high-cost hospital services; yielding savings that could be redeployed for other purposes.[17]

It follows that health payment and service redesigns — such as those outlined in the CIS Health Innovation Program's 'Health Innovation Communities' proposal[18] — that foster the development of integrated chronic care services, could potentially close the 11% 'healthcare cost gap' in the $70 billion-plus Medicare scheme, and produce savings that could more than fund the estimated $7 billion funding shortfall in the cost of the NDIS by 2028.

Conclusion: Don't Raise Tax — Reform Health to Fund the NDIS

The Medicare Levy is just another income tax, but a particularly onerous one. It is more demanding than normal income tax because the tax-free threshold does not apply, and is collected at 2% from first dollar earned. Adding half a percent to the rate may appear to be a small increase. But there has already been a 100% increase in the Medicare Levy from its original 1% rate, and an additional 0.5% increase would be a 150% cumulative increase since 1984. This is also not a small increase in the context of the total income tax burden, given that the average overall tax rate on taxable income is approximately 24%.

As shown here, the cost of health represents a major portion of the overall tax burden. Australian taxpayers are paying large amounts of income tax each year to fund the health system — effectively a 10% Medicare Levy to pay for all the Medicare-funded healthcare consumed each year. A substantial amount of the money used to fund the health system is wasted and props up latently inefficient health services. The heavy burden that health spending already imposes on income-earners, combined with the net welfare loss associated with inefficient health spending, casts a problematic light on calls to further hike the Medicare Levy to help fund the NDIS.

This report's proposal for paying for the NDIS — eschewing tax rises in favour of reforms that release the value locked up in inefficient publicly-funded health services for other purposes — is consistent with the Turnbull government's commitment to innovation and economic reform. It is also in keeping with the principles and recommendations of the 2015 Harper Competition Policy Review, which stressed the need for reforms in the health and human services sectors that foster innovation in service delivery and drive improvements in efficiency, in order to increase the overall performance and financial sustainability of these systems.[19]

Increasing the income tax burden would also be inconsistent with the overall strategy for Budget repair articulated by the Turnbull government: to reduce the deficit and debt by limiting expenditure through savings and efficiencies, not increase revenue through higher taxes. In the political context, hiking the Medicare Levy would be a breach of faith with Coalition voters supportive of lower taxation.

The NDIS is unaffordable in part because the former Labor government left the scheme un-funded.*** Yet its full implementation on schedule in 2020 remains bi-partisan policy. Rather than ask taxpayers to bail them out of their unaffordable, un-funded promises by hiking the Medicare Levy again, both sides of politics should commit to undertake major health reforms to deliver integrated health services for chronic disease — and devote the savings achieved to offset the cost of the NDIS.

*** This is not to overlook other factors that have led to the cost blowouts, or that efforts should be made to limit the cost of the NDIS, such as revisiting its scope and restricting eligibility, starting with reviewing the decision by the Gillard government to include mental ('psychosocial') and educational ('learning and social interaction') disabilities. Jeremy Sammut, 'A once healthy plan to deliver more with less now looks doomed', The Australian, 21 April, 2017.

Endnotes

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About the Author

Jeremy Sammut

Dr Jeremy Sammut is a Senior Research Fellow at The Centre for Independent Studies and Director of the CIS Health Innovations Program.

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Level 1, 131 Macquarie St, Sydney NSW 2000 • **phone:** +61 2 9438 4377 • **fax:** +61 2 9439 7310 • **email:** cis@cis.org.au