

health

# Victorian Government submission

Senate Committee Inquiry into the implementation  
of the National Health Reform Agreement



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# 1. Summary

The Commonwealth's decision midway through the 2012-13 financial year to strip almost half a billion dollars over the forward estimates and reduce its scheduled payments to Victorian hospitals in 2012-13 by \$107 million over seven months has had major negative consequences for the Victorian community, including the cancellation of Victorian hospital services and retrenchment of staff.

Nationally, the Commonwealth Government has unilaterally reduced the National Special Purpose Payments (SPP) for Healthcare by \$1.6 billion over the forward estimates. This is a reduction against the Commonwealth Government's 2012-13 Budget forward estimates.

- This reduction in Commonwealth funding has been communicated to all States and Territories by the Commonwealth Treasury.
- The Commonwealth Government began reducing its funding contribution into the National Health Funding Pool (a bank account into which Commonwealth and State and Territory funding are pooled before being dispersed to Local Hospital Networks) in December 2012 and is forecast to be a reduced payment by the Commonwealth every month for the remainder of the financial year.
- The Commonwealth reduction in its health funding payments has been confirmed by the Reserve Bank of Australia and the independent Administrator of the National Health Funding Pool.

All Victorian Local Hospital Network budget allocations increased in 2012-13, relying in part on the Commonwealth delivering on their May 2012 budget commitment. The Victorian Government has honoured its budget commitments and the Commonwealth is not honouring theirs.

The Commonwealth Treasurer has used incorrect population figures within the methodology used by the Commonwealth to reduce its allocation of funding. The Commonwealth has not followed sound and reasonable methodological practice and the Australian Statistician's advice to determine population *growth*. The Victorian Government also has concerns about the application of the health price index.

At the heart of the matter is the calculation of Australia's population growth rate between 31 December 2010 and 31 December 2011.

**It is now evident that the Commonwealth Treasurer has, in two separate agreements, determined that Australia's population growth rate between December 2010 and December 2011 was both 1.4 percent and 0.03 percent. For the same time period (December 2010 and December 2011), Australia's population could not have grown by two different rates.**

It is now also evident that:

- the Commonwealth Treasurer relied on advice from the Australian Statistician, and used revised population figures for December 2010 in making a Determination that Australia's population grew by 1.4 percent between December 2010 and December 2011 in finalising Local Government Funding (in June 2012); and
- the Commonwealth Treasurer ignored the same advice from the Australian Statistician in making a Determination that Australia's population grew by 0.03 percent between December 2010 and December 2011 in finalising health funding under the Health SPP (in October 2012);

Had the Commonwealth applied the latest available ABS revised estimate for the population of Australia at December 2010, the growth rate between 31 December 2010 and 31 December 2011 would have been 1.4 percent compared with the 0.03 percent the Commonwealth used.

**This error should be corrected.**

The Commonwealth's decision to act unilaterally; not reconsider its calculations despite numerous requests to do so; and failure to engage with all jurisdictions collaboratively to resolve issues has seriously hampered the implementation of the National Health Reform Agreement. The Commonwealth's actions are in direct opposition to the shared intention of the Commonwealth, State and Territory governments to work in partnership to improve health outcomes for all Australians and ensure the sustainability of the Australian health system. Additionally, these actions have failed to "provide more sustainable funding arrangements for Australia's health system". The processes adopted by the Commonwealth have failed to bring transparency and certainty to the funding of Local Hospital Networks.

The Commonwealth Government has in fact clawed back health funding from 2010-11, after patients have been treated; and has re-based health funding for every year into the future based on the incorrect application of population growth data.

Given the sudden cut in Commonwealth funding to Local Hospital Networks, made mid-way through the financial year, after hospitals had already set their budgets, hired staff and, in many cases, scheduled patients, Local Hospital Networks are having to delay treatments (such as elective surgery), close beds, and retrench staff to meet the reduced cash now being paid to them by the Commonwealth Government. That this is the immediate impact of a cash flow reduction should be of no surprise to those with a working knowledge of how health systems actually operate.

**To redress very significant disruptions, to avoid similar issues going forward and to ensure the successful implementation of the National Health Reform Agreement, Victoria recommends:**

- a. That the National SPP for Healthcare Determination of 20 October 2012 be withdrawn or amended for 2011-12 and the Mid-Year Economic and Fiscal Outlook (MYEFO) funding reductions reversed. The Commonwealth Treasury should correct the errors and repay the money into the Pool for Victorian Local Hospital Networks.
- b. That there are no future downward revisions in payments implemented mid financial year. A new process should be established (and agreed with all jurisdictions) so that Local Hospital Network budgets are not disrupted mid-year.
- c. That the Commonwealth Government agrees to adopt best available data and methodological practice in calculating and applying the Healthcare National SPP factors.
- d. That the application of data and methodology for calculating the Healthcare National SPP indexation is transparent and details disclosed and agreed with States and Territories.

## 2. Disruptive Impact of Reductions during the year

The decision by the Commonwealth Government to cut health funding amounting to \$403.48 million nationally over the last seven months of 2012-13 has had a significant and disruptive impact on States and Territories and implementation of the new national health reform arrangements. The Commonwealth Treasury's table below (sent to States on 1 November 2012) highlights the quantum of funding being withdrawn from each state and territory public hospital system.

At the time of release, November 2012, the Commonwealth determined that their cuts would be processed through a reduction of Commonwealth payments into the National Health Funding Pool established through the National Health Reform Agreement from December 2012.

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Total
2011-12 determination (\$ million)	48.90	39.71	40.15	6.34	10.96	1.95	0.60	1.05	<b>149.67</b>
2012-13 MYEFO (\$ million)	89.86	67.09	63.28	5.95	20.01	4.15	1.24	2.21	<b>253.81</b>
Total (\$ million)	<b>138.76</b>	<b>106.80</b>	<b>103.43</b>	<b>12.29</b>	<b>30.97</b>	<b>6.10</b>	<b>1.84</b>	<b>3.26</b>	<b>403.48</b>

Source: Commonwealth Treasury, sent to States on 1 November 2012

Between the May 2012-13 Commonwealth Budget and the November 2012 notification, the Commonwealth reduced its payments to Victorian Local Hospital Networks by \$107 million in 2012-13.

There are two components to the reduction in funding to Victorian Local Hospital Networks:

1. The Treasurer's Determination of the 2011-12 final National SPP for Healthcare outcome, which requires Victoria to repay \$39 million of funding that was previously paid by the Commonwealth. This is based on the Commonwealth Treasurer's Determination that the national population grew at only 0.03 percent in 2010-11. The Commonwealth Treasury advised this 2011-12 amount needs to be "repaid" in the 2012-13 year.
2. A 2012-13 adjustment for reducing payments by \$67.9 million.

The total reduction of cash to Victorian Local Hospital Networks in 2012-13 is therefore \$107 million.

As indicated above, the Commonwealth notified the States and Territories that the reduced Commonwealth payments would be made through the National Health Funding Pool (Pool). Under the National Health Reform Agreement, the Pool has been established for the purposes of line-of-sight of Commonwealth payments directly to hospitals.

Commonwealth reductions in monthly payments via the Pool began on 7 December 2012, when the Commonwealth reduced its monthly payment to Victoria by \$15.3 million. Victoria has received evidence from the Reserve Bank of Australia that Commonwealth funding into the Pool has reduced in December 2012, January 2013 and February 2013 by \$15.3 million per month. Therefore, from December 2012, Victorian Local Hospital Networks received a stark reduction in cash flow from the Commonwealth Government.

The full effect of the Commonwealth's cuts to Victorian funding equals \$475 million over the four years from 2012-13 to 2015-16. The impact of the Commonwealth funding cuts are being felt by each and every Victorian Local Hospital Network. These reductions will result (for example) in the following cuts to Local Hospital Networks:

- \$6.5 million to Western Health, a major growth corridor
- \$3.6 million to the Royal Children's Hospital
- \$4.9 million to Barwon Health
- \$630,000 to Bairnsdale Health

This unprecedented and unplanned mid-year Commonwealth funding cut directly to Local Hospital Networks (via the Pool) is having a real impact on front-line service delivery and outcomes for Victorian patients. The Commonwealth funding reduction could see:

- Over 500 beds close
- 10,000 elective surgeries cancelled
- Services reduced across many streams, including ED coverage, sub-acute, outpatient clinics and mental health.
- Over 260 (EFT) health services jobs lost.

Pressure on elective surgery and ED waiting times will be compounded by the Commonwealth decision to stop National Partnership Agreement on Improving Public Hospital Services funding from 2012-13. In 2012-13 the impact was a reduction of \$50.2 million.

### **The timing of the changes as they relate to hospital budgets and planning**

The National Health Reform Agreement confirms the Victorian Government's role as manager of the Victorian public hospital system. Unlike other states and territories in Australia, Victoria has a long established model of devolved governance, which is the major strength of the Victorian public healthcare system. The Victorian healthcare governance model provides local leadership across acute health, aged care, community health, social services and sub-acute services. There are 86 government-appointed healthcare boards and a further 38 registered community health boards (registered companies limited by guarantee) across the state. Boards of governance act as employers, are directly responsible for service provision, and set their own strategic directions in line with Victorian government policy and the demands arising from their local community.

The process of negotiating and agreeing hospital budgets commences in May each year, (coinciding with the release of the Victorian and Commonwealth budgets) allowing a considerable lead time for Local Hospital Network budgets to be negotiated and finalised through the development of 'Statement of Priorities' and Service Agreements. These agreements specify performance priorities for each individual Local Hospital Network, activity levels, and in 2012-13 for the first time Commonwealth and State activity based funding contributions via the National Health Funding Pool.

In the months following the State and Commonwealth budgets (May), discussions occur between Local Hospital Networks and Victorian Department of Health representatives and include:

- Expected growth from demand, elective surgery activity and expected financial results based on budgets.
- The department allocates growth based on activity data and new capacity.
- Local Hospital Networks seek endorsement from their boards.

In July 2012, Victorian hospital budget allocations were made, in part relying on the Commonwealth delivering on their May 2012 budget commitment. By October 2012, Local Hospital Networks had:

- Recruited staff;
- Planned theatre lists and communicated with patients around elective surgery expectations; and
- Undertaken resource management for the year ahead.

The implications of the Commonwealth Treasurer's unilateral funding determination in October 2012 are that all Local Hospital Networks across Victoria have had to make savings mid way through the financial year. While efforts have been made by each Local Hospital Network to reduce the impact on front-line services, there has already been a significant state-wide wind back the amount of services that can provided.



### 3. SPP Indexation arrangements

Under sections A32 and A33 of the National Health Reform Agreement signed in August 2011, the Commonwealth contribution to Local Hospital Networks for 2012-13 and 2013-14 is provided under the terms of the National SPP for Healthcare. From 1 July 2014, the Commonwealth will instead fund 45 percent of efficient growth of activity based services, increasing to 50 percent from 1 July 2017.

Funding arrangements under the NSPP for Healthcare are set out in the Intergovernmental Agreement on Federal Financial Relations (IGA), signed 29 November 2008.

The IGA (Paragraph D21) specifies a Commonwealth financial contribution of \$11,224,185,000 (nationally) for 2009-10 under the Healthcare SPP. This is the base to which indexation is applied.

Annual indexation of the Healthcare SPP uses the following formula. The components of the formula are:

- growth in population estimates weighted for hospital utilisation;
- the rolling 5 year average of the Australian Institute of Health and Welfare (AIHW) health price index; and
- a technology factor (Productivity Commission derived index of technology growth – fixed at 1.2 per cent).

In April 2011, the (then) Ministerial Council on Federal Financial Relations agreed that all National Specific Purpose Payments would be indexed using the '**latest available growth factor data**'. The Treasurer's determination and any subsequent residual adjustment would be based on the most recent growth factor data '**available at 30 June of the payment year**' and no further residual adjustments would be made to capture any revisions to data after that time.

#### National Health Funding Pool

The 2011-12 National SPP for Healthcare determination is the first time that the adjustments to SPP amounts have been made via the National Health Funding Pool, which was established in July 2012. Commonwealth funding (and reductions to funding) for hospital services is paid into the Pool and from the Pool directly to Local Hospital Networks without going via State Treasuries as had been the case for Commonwealth funding contributions prior to July 2012.

As a consequence of the Pool, any and all payment reductions in to the Pool must be matched one-for-one with reduced payments out. For this reason the National Health Funding Pool Administrator advised all States at the beginning of November 2012 of the reduced Commonwealth contributions for each and every Local Hospital Network in the country.

Since the indexation on the Health SPP takes a year on year approach, the 2011-12 revision to the population estimates, if unamended, will have ongoing implications for Commonwealth health funding – effectively lowering base funding and future Commonwealth required contributions.

## 4. Fundamental Error of an Irrefutable Nature

**The Commonwealth has not used the latest available December 2010 population estimate**

1. The national population for 31 December 2011 provided by the Australian Statistician (for the first time in June 2012) is adopted in the Local Government Act Determination, and in the Healthcare Special Purpose Payments (SPPs) determination (22,482,217 persons).
2. The Local Government Determination uses a population figure for December 2010 (22,179,728 persons) provided by the Australian Statistician as an updated figure.
3. The Healthcare SPP Determination uses a different population figure for December 2010 (22,474,906 persons).
4. The Local Government Determination uses population estimates outlined by the Australian Statistician in his letter of 14 June 2012, which shows Australia's population growth of 1.4 percent between December 2010 and December 2011.
5. In contrast, the Commonwealth Treasurer's determination of 20 October 2012 for the Healthcare SPP assumes a national population growth rate of 0.03 percent with an assumed fall in the Victorian population of 11,111 persons.

**It is now clear, that the Commonwealth Treasurer has, in two separate agreements, determined that Australia's population growth rate between December 2010 and December 2011 was both 1.4 percent and 0.03 percent.**

**For the same time period (December 2010 and December 2011), Australia's population could not have grown by two different rates.**

The following documents assist the Senate Committee in considering this matter:

- Independent analysis by KPMG that supports the key findings that an error has occurred, involving incorrect calculations and obsolete data ([see Attachment A](#)).
- the letter from the Australian Statistician dated 14 June 2012 outlining the updated and correct population data to use for December 2010 and December 2011 ([see Attachment B](#));
- the Commonwealth Treasurer's Local Government Determination for 2012-13, signed on 29 June 2012 ([see Attachment C](#));
- the Commonwealth Treasury table outlining the (incorrect) population data used by the Commonwealth Treasurer in his Healthcare SPP Determination made in October 2012 ([see Attachment D](#)).
- Evidence received by Victoria from the Reserve Bank of Australia that Commonwealth funding into the Pool has reduced in December 2012, January 2013 and February 2013 ([see Attachment E](#)).

### **Census Application Error**

The Commonwealth's approach calculates a 0.03 percent population growth rate based on an old data series (from the 2006 Census) and a new data series (from the 2011 Census).

This approach loads the intercensal error for 2006-2011 of minus 294,000 persons into the estimates of population change for a single year (December 2010 and December 2011), rather than smoothing the intercensal error over 20 years, as the ABS has indicated it will do.

The ABS has committed to publishing the revised undercount adjustments in the 20 June 2013 issue of Australian Demographic Statistics.

The following document assists the Senate Committee in considering this matter:

- ABS publication: "The 2006-2011 Intercensal period and revisions to historical ERP" (see Attachment F).

## 5. Lack of Transparency

The other parts of the indexation formula – other than raw population growth – include a Technical Factor (1.2 percent), a Total Health Price Index (AIHW), and a 'hospital utilisation' component.

The 'hospital utilisation' factor is calculated by the Commonwealth Treasury using Department of Health and Ageing data. For 2011-12 the utilisation factor hit an historic low of 0.3 percent but with no transparent reason or explanation. During 2009-10 and 2010-11 it averaged 0.6 percent per annum. However, no reason has been given and no transparency has been given to the working papers.

For the 2012-13 MYEFO adjustment, the Commonwealth also adjusted the AIHW total health price index component of the SPP indexation formula in line with the latest available data as published by the AIHW in September 2012. The 2010-11 figure used (0.9 percent) significantly lowers the five year average to 2.27 percent, whereas it had previously been hovering around 3.0 percent.

The outcome is NOT consistent with any other published figures on the same subject matter. For example, the Independent Hospital Pricing Authority calculated that costs grew at 5.1 percent over the same period, and the health price inflation factor used for Private Health Insurance indexation has grown by over 5 percent for each of the past three years.

Victoria's own data would confirm the AIHW Total Health Price Index figure for 2010 has significantly understated health and hospital cost inflation.

## 6. Key Factual Findings

The Victorian Government recommends that the Senate Committee considers the following observations and facts:

- a. That the Commonwealth Government as part of the National SPP for Healthcare Determination for 2011-12 and MYEFO for 2012-13 advised States and Territories that payments into the National Health Funding Pool would be reduced by \$403.48 million nationally over seven months during 2012-13. Notice was given to the States and Territories in November 2012 for implementation to commence in December 2012, without consultation or an avenue for fully-informed discussion or negotiation.
- b. The Commonwealth is not honouring their May 2012 budget commitments.
- c. That the impact of reduced Commonwealth payments through the Pool and directly to Local Hospital Networks mid-year has been unprecedented, disruptive, with negative impacts on front-line service delivery, wait lists, patient outcomes and staffing.
- d. The reduction of payments into the National Health Funding Pool has been evidenced by Reserve Bank of Australia Receipts between 7 November and 7 December, 2012, indicating a national reduction of \$57.57 million per month, which has continued for the months of January and February 2013. An impact for Victorian Local Hospital Networks of \$15.3 million less per month.
- e. The Commonwealth Treasurer has, in two separate agreements, determined that Australia's population growth rate between December 2010 and December 2011 was both 1.4 percent and 0.03 percent. For the same time period (December 2010 and December 2011), Australia's population could not have grown by two different rates.
- f. The National SPP for Healthcare Determination for 2011-12 used a flawed population growth factor of 0.03 percent. This is an error and the Commonwealth Treasurer ignored the independent advice from the Australian Statistician.
- g. The estimates of resident population growth between December 2010 and December 2011 used in the National SPP for Healthcare indexation did not incorporate the latest data supplied to the Commonwealth by the Australian Statistician for December 2010.
- h. The calculations for the SPP indexation for 2011-12 included data that was inconsistent, obsolete and not meeting the test of 'latest available'. A fundamental error has occurred.
- i. The Commonwealth Government has not been transparent in how they have calculated and applied indexation under the National SPP for Healthcare.
- j. The Commonwealth Government has not adopted best available data and methodological practice in calculating and applying the Healthcare National SPP factors.
- k. The recent experience of the Victorian health sector with the new funding pool arrangements and the Commonwealth disruption to budget and operations, constitutes a major loss of confidence in 'national health reform'.

## 7. Recommendations

**To redress very significant disruptions, to avoid similar issues going forward and to ensure the successful implementation of the National Health Reform Agreement, Victoria recommends:**

- a. That the National SPP for Healthcare Determination of 20 October 2012 be withdrawn or amended for 2011-12 and the 2012-13 MYEFO funding reductions reversed. The Commonwealth Treasury should correct the errors and repay the money into the Pool for Victorian Local Hospital Networks.
- b. That there are no future downward revisions in payments implemented mid financial year. A new process should be established (and agreed with all jurisdictions) so that Local Hospital Networks budgets are not disrupted mid-year.
- c. That the Commonwealth Government agrees to adopt best available data and methodological practice in calculating and applying the Healthcare National SPP factors.
- d. That the application of data and methodology for calculating the Healthcare National SPP indexation is transparent and details disclosed and agreed with States and Territories. The working documents and calculations that underpin the Treasurer's Determination should be released in full.

## 8. Attachments

- a. Independent analysis by KPMG that supports Victoria's view that an error has occurred, involving incorrect calculations and obsolete data
- b. Letter from the Australian Statistician dated 14 June 2012 outlining the updated and correct population data to use for December 2010 and December 2011
- c. Commonwealth Treasurer's Local Government Determination for 2012-13, signed on 29th June 2012
- d. Commonwealth Treasury table outlining the (incorrect) population data used by the Commonwealth Treasurer in his SPP Determination made in October 2012
- e. Reserve Bank of Australia receipts
- f. ABS publication: "The 2006-2011 Intercensal period and revisions to historical ERP"