

## **Unnecessary Pain? Victoria's health cuts: who is responsible and how we can make sure they don't happen again**

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On October 22, 2012, the Federal Government released its Mid Year Economic and Fiscal Outlook (MYEFO) for the current financial year. It received more press than is usually the case because it contained details of some significant budget cuts and revenue increases. These were needed to ensure the Federal budget remained on track to deliver a surplus in 2012/13 in the face of worse than expected revenues (Commonwealth Government, 2012b: 1).

In the detail of the MYEFO was a reduction in specific purpose payments to the states for health, affecting NSW, Queensland and Victoria in particular. When Victoria realized the extent of the cuts, the State repeatedly criticized the Federal Government for the size of the cuts and their timing. The Federal Government responded by pointing to the Victorian government's four rounds of budget cuts from 2010/11 onward as a better explanation as to why the state's health services were experiencing a difficult time (see for example 'Health funding cuts to hurt Victorian patients', Herald Sun, November 30, 2012)

Getting to the bottom of the story is proving difficult, with both sides blaming one another. The Australian Nursing Federation (Victorian Branch) has commissioned this report with a view to assessing the competing claims. Specifically I have been asked to do the following:

- Examine trends in Victorian health budgets between 2009/10 and 2012/13;
- Review the decision of the Federal Government to reduce its health funding to Victoria based on population data with a view to answering the question: was the Federal Government's decision consistent with usual practice in terms of population adjustments and, if not, what would the funding adjustment have been had usual practice been followed?

### Key Findings

1. Total Victorian "health expenses", or the amount the State spends on health, when adjusted for inflation, increased in 2011/12 by 5% and by 2.3% this financial year.
2. The forward estimates show that when adjusted for inflation and population increases of approximately 1.2% per year, health expenses will fall slightly in 2013/14 and 2015/16 (although "contingency reserves within the budget could be deployed to ensure spending is at last maintained in real terms).
3. State Government savings measures announced since May 2011 have cut overall general government spending by \$542m in 2011/12, \$1,184m in

2012/13, rising to over \$2.2b by 2015/16. Most of the effect of these efficiency measures is yet to be felt.

4. Federal Government health payments to Victoria, or the amount the Commonwealth provides to Victoria for health purposes, has increased substantially in each and every year from 2009/10 to 2015/16, with the exception of this financial year, when they will fall by almost 6% in real terms.
5. Substantial increases in Federal payments for every year except this one are the main driver of increased health funding.
6. Over the 7 years to 2015/16, the Federal Government's contribution to total Victorian health expenses is projected to increase from 25.3% to 31.2%
7. The Federal Government adjustment this year was consistent with its obligations to the State under the Commonwealth/State funding agreement signed by the Premier in February 2011.
8. There is no discernible macroeconomic effect between a small surplus and a small deficit; the Federal government decision to insist on the cuts cannot be justified on economic grounds;
9. The State's decision not to cover the shortfall from its own resources also cannot be justified on economic grounds.
10. The dislocation caused by the Federal cut to health payments this year could be addressed by the Federal Government agreeing to shift the budget adjustment into the outyears on the understanding that this will apply to all future adjustments, including those that would otherwise increase health payments to Victoria mid-way through a future financial year.

The report is divided into four parts. The first looks at overall trends in health spending in Victoria between 2009/10 and 2012/13, and the contribution of the Federal Government to this spend. It also looks at the forward estimates of health spending through to 2015/16. I show a complex picture in which the overall trend is a modest increase in health expenses, driven largely by Federal Government payments, with one notable exception. This is 2012/13, when real Federal health payments will decline by almost 6%. Despite this, overall Victorian health expenses will increase by over 2% in real terms.

The second part focuses specifically on the question of health budget cuts. Here I focus on State and Federal cuts and summarise each jurisdiction's explanations for their reductions. I explain that the reason for the real cut in Commonwealth payments for 2012/13 is revised and more accurate data that the States and the Federal Government agreed would form the basis of health payment movements on an annual basis.

In the third part I try to explain why the Federal Government has remained determined to impose budget cuts mid-way through a financial year when it was

pretty clear that, in so doing, there would be significant dislocation of health services. It is likely the Federal Government stuck to its guns on this matter because of its determination to return the budget to surplus in difficult financial times, while the State remained unwilling to chip in to make up the difference because of its own troubled financial position.

In the final part I look at what might be done in the future to prevent this type of event occurring again.

I begin with the data on health spending in Victoria from 2009/10-2015/6.

### Part 1: Victorian government health spending and federal health payments

Table 1 shows Victorian government health expenses from 2009/10 to 2015/16. On the left hand side are Victorian health expenses in nominal and constant dollars (ie adjusted for inflation). The figures show a substantial real increase in 2011/12 of almost 5%, falling to 2.3% this financial year, a small real fall next year and modest increases thereafter of less than 0.5%. If we were to adjust these figures for population growth of around 1.2% per annum, they would show a real per capita fall in health expenses in 2010/11, and from 2013/14 onward. It should be noted, however, that it is likely that “contingencies” funding will be available to ensure health spending is maintained in real terms.

**Table 1: Victorian government health expenses, 2009/10-2015/16, in nominal and constant prices (2012/13=100)**

	Victorian Health expenses			Commonwealth health payments		
	Nominal	Constant (2012/13)		Nominal	Constant (2012/13)	
June:	\$m	\$m	% change	\$m	\$m	% change
2010	\$11,538	\$12,479		\$2,914	\$3,152	
2011	\$12,011	\$12,601	1.0%	\$3,454	\$3,624	15.0%
2012	\$12,862	\$13,216	4.9%	\$3,732	\$3,835	5.8%
2013 budget	\$13,519	\$13,519	2.3%	\$3,612	\$3,612	-5.8%
2014 est	\$13,817	\$13,480	-0.3%	\$3,954	\$3,857	6.8%
2015 est	\$14,206	\$13,521	0.3%	\$4,171	\$3,970	2.9%
2016 est	\$14,559	\$13,520	0.0%	\$4,541	\$4,216	6.2%

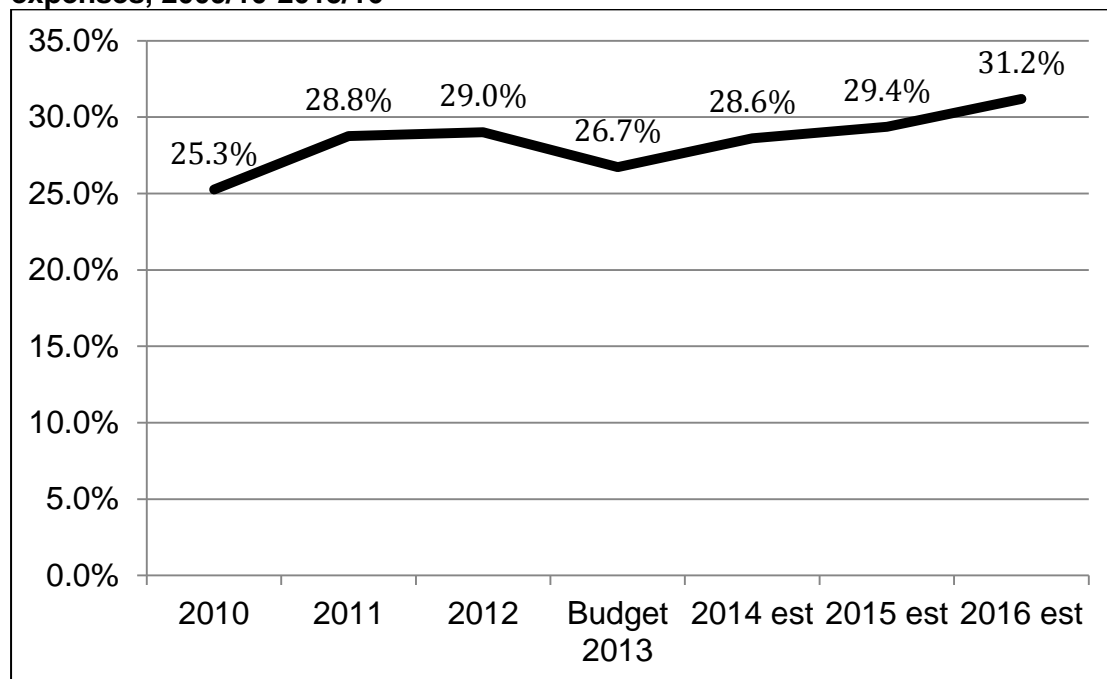
Note: deflated by CPI for Melbourne. Note: there is a small discrepancy between my figures and those referred to in the press, which I am unable to reconcile based on the published data. For example, Victoria continues to refer to \$107m in federal cuts in 2012/13, but the data in the MYEFO seem only to show a \$91m reduction. I suspect that the difference is due to the media focus on National Health Reform Funding, which if you combine the 2011/12 and 2012/13 figures amounts to \$107m

Sources: Health expenses from Victorian Budget Papers, Budget Paper Number 5, Financial Statements (2009/10-2011/12), 2012/13-2015/16 from Victorian Budget 2012/13 Financial Data Sets available at <http://www.budget.vic.gov.au/CA2579B200132B63/pages/financial-data-sets>, published on December 14 2012 and accessed on February 6 2013. Commonwealth Health grants from Commonwealth Government (2012), Mid Year Economic and Fiscal Outlook, 2012/13.

The right hand side of the table shows Federal health payments to Victoria. Overall the picture is positive, with real payments increasing substantially in each and every year, with the exception of only one year. This financial year real payments will fall by almost 6%. Paradoxically, it is State Government funded health expenditures that will ensure health expenses rise in real terms by more than 2% for this financial year.

This trend is demonstrated by Figure 1, which shows overall Federal payments increasing as a share of state health expenses for every year except 2012/13, when they will fall. Over the 7 year period they are projected to increase from 25.3% to 31.2% of total state health expenses.

**Figure 1: Federal health payments as a percentage of Victorian health expenses, 2009/10-2015/16**



Sources: See Table 1.

Table 2 provides more detailed information on Commonwealth health payments, for these are made up of two quite different components. The main component consists of National Health Reform funding (which were previously Health Specific Purpose Payments or SPPs). The other component is partnership payments for agreed activities by the State, much of which is subject to meeting performance targets (for example emergency admissions). The Table compares the payments that were pledged in the May 2012 Federal budget with the payments listed in the MYEFO. The Table shows that the biggest reductions in funding are to National Health Reform payments, which are projected to be \$476m less from 2011/12 through to 2015/16 than was estimated at budget time.

**Table 2: Commonwealth health payments by type, 2009/10-2015/16, Budget 2012/13 compared to 2012 MYEFO (\$m)**

	Budget Paper No 3			MYEFO 2012				Total	
	National Health Reform and SPPs	Partnerships	Total	National Health Reform	Partnerships				
Year to June:	\$m	\$m	\$m	\$m	reduction \$m	\$m	reduction \$m	\$m	reduction \$m
2010	\$2,711.0	\$202.8	\$2,913.8						
2011	\$2,910.0	\$544.1	\$3,454.1						
2012	\$3,099.4	\$698.7	\$3,798.1	\$3,059.7	-\$39.7	\$672.4	-\$26.3	\$3,732.1	-\$66.0
Budget 2013	\$3,322.5	\$380.9	\$3,703.4	\$3,255.3	-\$67.2	\$356.9	-\$24.0	\$3,612.2	-\$91.2
2014 est	\$3,584.0	\$507.9	\$4,091.9	\$3,483.6	-\$100.4	\$470.3	-\$37.6	\$3,953.9	-\$138.0
2015 est	\$3,961.2	\$301.0	\$4,262.2	\$3,839.6	-\$121.6	\$331.7	\$30.7	\$4,171.3	-\$90.9
2016 est	\$4,373.0	\$232.5	\$4,605.5	\$4,225.0	-\$148.0	\$315.5	\$83.0	\$4,540.5	-\$65.0
<i>Total cut</i>					-\$476.9		\$25.8		-\$451.1

Source: see Table 1

## Part 2: Federal and State health cuts: what's their impact?

One of the contributing factors to the substantial slowing in the rate of increase in State health expenses from 2013/14 onward is State Government budget cuts to health announced in the 2011/12 budget, the 2011/12 budget update, the 2012/13 budget and the 2012/13 budget update (see Table 3).

**Table 3: Savings measures announced by the Victorian government (\$m), 2011/12-2015/16 (\$m)**

	2012	2013	2014	2015	2016
2011/12 Budget	\$475	\$511.1	\$520.3	\$536.7	\$536.7
2011/12 Budget update	\$67	\$404	\$661	\$943	\$1,215
2012/13 Budget		\$242	\$266	\$268	\$240
2012/13 Budget update		\$27	\$118	\$204	\$290
<b>Total</b>	<b>\$542</b>	<b>\$1,184</b>	<b>\$1,565</b>	<b>\$1,952</b>	<b>\$2,282</b>

Source: Victorian Government, [Budget Update, 2011/12](#); Victorian Government, [Budget Strategy and Outlook, 2012/13](#), Budget Paper No 2: 5; Victorian Government, [Budget Update, 2012/13](#).

As Table 3 shows, the combined effect of the efficiency measures is to reduce spending in the General Government sector by \$542m in 2011/12, \$1,184m in 2012/13, rising to \$2.28b by 2015/16. Most of the effect of these efficiency measures is yet to be felt.

The effect of these cuts in health are shown in Table 4. The Table shows that the annual savings from the health budget from State government efficiency measures amount to more than \$130m per annum. It should be noted that this excludes additional efficiency measures announced in the 2012/13 budget update, that are meant to kick in from 2014 but which were not published in the budget update.

**Table 4: Victorian budget cuts to health, 2010/11-2015/16 (\$m)**

	2011	2012	2013	2014	2015	2016
2011/12 Budget	\$38	\$77	\$79	\$81	\$83	\$83
2011/12 Budget update		\$10	\$20	\$20	\$20	\$20
2012/13 Budget			\$32	\$33	\$34	\$35
<b>Total</b>		<b>\$87</b>	<b>\$131</b>	<b>\$134</b>	<b>\$137</b>	<b>\$138</b>

Sources: Victorian Government (2011), Efficiency Savings Background Brief, Victorian Treasury, p. 2; Victorian government (2012), 2012/13 Budget Update; Victorian government (2012), Budget Paper No 3, Service Delivery.

To these reductions of course must be added those arising from the Federal Government’s 2012 decision to reduce health payments to Victoria as documented earlier. The combined cuts are shown in Table 5. The Table shows that in total, Victorian health services have experienced budget cuts which this year will amount to \$222m, rising to \$272m next year). The Commonwealth government is responsible for less than half the total cuts. Only in 2013/14 does the Commonwealth account for more than 50% of the total, and then by only 1 percentage point.

**Table 5: Victoria’s health budget cuts by level of Government, 2010/11-2015/16 (\$m)**

	Year to June:					
	2011	2012	2013	2014	2015	2016
State cuts	\$38	\$87	\$131	\$134	\$137	\$138
Commonwealth cuts	\$0	\$66	\$91	\$138	\$91	\$65
Total	\$38	\$153	\$222	\$272	\$228	\$203
Commonwealth %	0%	43%	41%	51%	40%	32%

Source: Tables 2 and 3

It is not the total level of cuts that has caused the current amount of concern, however. Of greater significance is the timing of the cuts. Whereas health services and the Department have been given a chance to prepare for the cuts imposed by the State Government, the opposite has been true with respect to the Federal cut this year. By announcing the reduction almost halfway through the financial year, the Federal Government gave the health services effectively no time to adjust their budgets. By the time the cuts were announced, budgets had been prepared and health services were spending against them. By requiring the health services to manage cuts half way through the financial year, the Federal government effectively doubled the real impact of the funding reduction; for it is of course much easier to manage a given budget cut over 12 months than it is over 6.

It is for this reason that the health services have complained so bitterly about their effect. As Duckett (2013) explains:

“In most states budgets had already been issued to hospitals and so in passing on the Commonwealth hit, the political accountability was made clear. Hospitals, forced to revisit their budgets, have been required to find savings quickly and have implemented a full year of cuts over the five months after Christmas, exacerbating the impact of the Commonwealth cuts”.

Why did the Federal Government undertake such apparently harsh action? The National Health Reform agreement is pretty clear about the basis on which federal payments for health would be made. It specifies a base year and also the factors on which future increases will be based. The Federal Government explains it this way:

“The National Health Reform funding indexation rates are derived from three factors – the independent Australian Institute of Health and Welfare calculations of growth rates in the cost of health services, population shifts and a technology factor of 1.2 percent.” (Commonwealth Government, 2012a: 75)

Of these, the first two were subject to substantial revision due to the release of more accurate data in the lead up to the preparation of the MYEFO. In the case of population growth, the revised data came from the 2011 Australian census, which showed previous population trend estimates to be wrong. When the more accurate data were used, they showed that the Australian Bureau of Statistics had over estimated Victoria’s population growth in between the two census. As Stephen Duckett (2013) has recently explained:

“The source of population growth estimates is the Australian Bureau of Statistics (ABS), which changed its method of population estimation. The only accurate measure of the population occurs at the census, and even that isn’t perfect. To check the census estimates, the ABS conducts a survey to verify what was reported, to check on people who have come back home after being away on census night and so on. For the 2011 census the ABS changed the way it did that, which changed the census base-line. Between censuses, the ABS makes “inter-censal” estimates by adding births, subtracting deaths and taking account of population movements. Obviously the beginning and endpoints of the inter-censal estimates ought to reconcile with the census, but for 2011 [in Victoria] they were 300,000 or so people out. Some states were previously recorded as having a larger population than the new estimates (NSW 1.3% over, Victoria 1.6% over, Queensland 2.4% over), with other states being slightly under counted.”

A second factor contributing to the revised estimates was a significant downward revision in the estimated cost index for health, partly because of the effect of the rising value of the Australian dollar.

There is no doubt that the data adjustments were fair, reasonable and done according to an agreement to which all parties were signatories. It did not help matters that Victoria complained about the data initially for the wrong reasons, suggesting that the Federal Government had imposed the cuts on the spurious ground that Victoria’s population had fallen when it was clearly increasing (see for example <http://www.bordermail.com.au/story/1170827/davis-plea-on-spurious-health-cuts/> accessed on 7 February 2013).

Nevertheless, the question arises as to why the Federal Government would enforce a budget adjustment mid-way through the financial year? The answer would seem to be a very strong desire by it to achieve a budget surplus in the context of much softer revenues than had been budgeted for. The MYEFO contained \$2.1b of savings in 2012/13, rising to \$4b in 3 year’s time, of which the health component amounted to over \$400m across all of the states for this financial year. The Federal Government

took the view that these savings were needed in order to keep the growth in spending to a minimum in order to allow the budget to move back into surplus:

“The Government is delivering on its commitment to restrain real growth in spending to 2 percent a year on average, until surpluses are at least 1 percent of GDP...Average real growth in payments in 2012/13 and across the forward estimates is around 1.1%...(Commonwealth Government, 2012b: 39).

From an economic standpoint, there is no discernable effect between a small surplus and a small deficit; whether the deficit is \$400m more or less is of little economic consequence from the point of view of the \$1 trillion economy as a whole. The decision to enforce the health cuts was political rather than one borne of economic necessity.

It might be also asked why the State Government did not consider allowing its own budget position to deteriorate, rather than enforce the cuts? The Victorian government has taken a strong view that the State budget must remain in surplus (see for example <http://www.theage.com.au/victoria/public-sector-jobs-to-go-in-biggest-cuts-since-kennett-20120501-1xxd5.html>) and that the sustainability of its finances depends on it increasing the size of its surplus so that it can fully fund a large but declining infrastructure program in future years while repaying debt. This is shown in Table 6, which contains data on the budget’s operating surplus, net infrastructure investment and net debt from 2012/13 through to 2015/16.

**Table 6: Victorian government operating surplus, net infrastructure investment and net debt, 2012/13-2015/16 (\$m)**

	Year to June:			
	2013	2014	2015	2016
Operating surplus	\$136.9	\$834.7	\$1,260.0	\$2,636.8
Net infrastructure investment	\$5.6	\$5.8	\$4.1	\$3.7
Net debt	\$20.1	\$23.0	\$23.9	\$23.9
Net debt % of GSP	5.8	6.4	6.3	6

Source: Victorian Government (2012), Budget Update, 2012/13, p. 19.

For the current financial year, Victoria, like all the States bar Western Australia, is also struggling to keep its books in the black in the context of sluggish GST revenues and a decline in property market-related taxes. It is for this reason that it is reluctant to commit to increasing its own health spending to compensate for the sudden reduction in Federal grants.

From an economic standpoint, however, there is no discernable difference between the State budget having a \$100m surplus or being in balance. The decision to keep the budget in the black is borne of a political and social philosophy rather than economic necessity.

Similarly, there are no compelling economic grounds to justify the State not increasing its own health spending throughout the forward estimates to accommodate



the Federal cuts. While its operating surplus would be lower, the difference would be marginal. Also, it should be borne in mind that Victoria's level of indebtedness is low not only by historical standards, but also by comparison to comparable international jurisdictions such as the Canadian provinces (for example, the Canadian province of Ontario is budgeting for net debt equivalent to 39.1% of GDP this financial year compared to 10.3% for the Victorian public sector (Government of Ontario (2012), Economic Outlook and Fiscal Review, 2012, p. 121, accessed at: [http://www.fin.gov.on.ca/en/budget/fallstatement/2012/paper\\_all.pdf#page=120](http://www.fin.gov.on.ca/en/budget/fallstatement/2012/paper_all.pdf#page=120) on 17 February 2013).

### **Part 3: What might be done to make sure it doesn't happen again?**

Duckett (2013) argues that the dislocation caused by the Federal cuts to health payments could be addressed by the Federal Government agreeing to shift the budget adjustment into the outyears, thereby taking the pressure off health services having to adjust their budgets half way through a financial year. I agree entirely with this suggestion and would recommend in future that updated data not be used to adjust upward or downward payment streams that are already in train. "Bank errors" will work both ways, and over time neither the Federal Government nor the States should be worse off as a result.

### **Conclusion**

This paper was commissioned to provide answers to two questions. The first involved trends in Victorian health budgets. I have shown that during the 7 years to 2015/16, the trend in Victorian health expenditure has been toward zero real growth, with early years of real increases being replaced by zero or declining real per capita expenses (with the important caveat that there are likely to be funds available in the contingency reserve to ensure that in reality health spending is at least maintained in real terms). Overall, the Federal Government's health payments have been growing faster than State health spending, with the notable exception of 2012/13. During this year, Federal payments have fallen by almost 6%, but despite this overall Victorian health expenses will increase in real terms by more than 2%.

The second question I was asked to consider is the decision of the Federal Government to reduce its health funding to Victoria based on population data with a view to answering the question: was the Federal Government's decision consistent with usual practice in terms of population adjustments and, if not, what would the funding adjustment have had usual practice been followed? It is clear to me that the Federal Government has followed an agreed approach. The data it has drawn on is "clean" and derived from independent sources.

Nevertheless, this does not mean that the process has been a good one, or one that should be repeated in the future. Far from it. Indeed, following Stephen Duckett, it is my view that the Federal Government and the States should agree on a protocol that there will be no within year budget adjustments to spending programs, especially those involving sensitive areas like hospital services. Rather, it should be agreed that the adjustments will be made in the outyears, to give service providers a reasonable chance to make adjustments to their budgets in ways that minimize service disruptions.

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<sup>i</sup> Disclosure: I am a Board member of Melbourne Health. The views expressed here are my own.