Balancing the NHI funding requirements with the economic capacity of South Africa

NHI Colloquium

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Tough choices in difficult times

- South Africa faces exceptionally difficult global and domestic economic conditions over the next several years. All the choices before us are disagreeable, some more than others. Drawing on the country's resilience, it is necessary to make tough decisions.

- The 2016 Budget proposals will return the public finances to a sustainable path. The Budget sets out tax increases and spending reductions to narrow the fiscal deficit and stabilise growth of public debt, while protecting core social and economic programmes.

- Yet fiscal measures are not enough. To expand the social wage in a sustainable manner, create jobs and reduce poverty, South Africa needs much faster rates of inclusive economic growth. In today's conditions, doing so requires a sense of common purpose.

- The 2016 Budget emphasises both public- and private-sector contributions to development. Over the period ahead, government is stepping up its partnerships with business, labour and civil society to realise the vision of the National Development Plan, and to carry out the reforms needed to transform the economy.

Economic outlook reflects worsening growth

- Growth reduced across the forecast period - drought, weak commodity prices, slower than expected expansion in global growth
  - Investment growth lower due to weaker confidence, rand and commodity prices
  - Household spending reduced by higher inflation, lower job creation
  - Electricity remains a constraint on growth through till 2018
- Headline inflation above target band until 2018 due to weaker rand, drought-related food inflation and electricity price increases.

	2012	2013	2014	2015	2016	2017	2018
Percentage change		**Actual**		**Estimate**		**Forecast**	
Final household consumption	3.4	2.9	1.4	1.4	0.7	1.6	2.2
Final government consumption	3.4	3.3	1.9	0.4	1.2	-0.2	0.2
Gross fixed capital formation	3.6	7.6	-0.4	1.1	0.3	1.4	2.7
Gross domestic expenditure	3.9	1.4	0.6	0.1	1.1	1.7	2.2
Exports	0.1	4.6	2.6	9.5	3.0	4.6	5.2
Imports	6.0	1.8	-0.5	5.3	3.7	4.5	4.9
Real GDP growth	**2.2**	**2.2**	**1.5**	**1.3**	**0.9**	**1.7**	**2.4**
GDP inflation	5.5	6.0	5.8	4.0	6.7	6.3	6.0
GDP at current prices (R billion)	**3 262.5**	**3 534.3**	**3 796.5**	**3 998.9**	**4 305.9**	**4 657.5**	**5 052.8**
CPI inflation	5.7	5.8	6.1	4.6	6.8	6.3	5.9
Current account balance (% of GDP)	-5.0	-5.8	-5.4	-4.1	-4.0	-3.9	-3.9

Source: Reserve Bank, National Treasury

Government has responded to restore confidence

- Fiscal policy has responded pre-emptively to avoid the risk of a negative cycle of declining confidence, lower growth and increased borrowing costs.
- Fiscal consolidation measures totalling R18 billion in 2016/17, R25 billion in 2017/18 and R30 billion in 2018/19 due to higher revenue, lower spending and reprioritisation.

R billion	2015/16	2016/17	2017/18	2018/19
2015 Budget Review				
Expenditure reductions	10	15		
Revenue increases	17			
2016 Budget Review				
Expenditure reductions			10	15
Revenue increases		18	15	15

- Net debt is projected to stabilise at 46.2 per cent of GDP in 2017/18, two years earlier than was estimated at the time of the 2015 MTBPS.
- Net MTEF additions of R33.7 billion to the provincial equitable share; R4.2 billion added to the local government equitable share.

Fiscal consolidation accelerated

Tax measures

- In 2016/17, an additional R7.6 billion raised through limited fiscal drag relief, R9.5 billion through increases in the fuel levy and specific excise duties, and R2 billion from adjustments to capital gains tax and transfer duty.
- Tax increases of R15 billion in 2017/18 and R15 billion in 2018/19, with details of proposals to be set out in subsequent budgets following consultation and review.

Spending ceiling

- Reductions of R10 billion in 2017/18 and R15 billion in 2018/19 applied to the compensation budgets of national and provincial departments.
- A block on administrative and managerial vacancies starting in April 2016. Appointments considered only after departments have submitted clear human resource plans aligned with reduced compensation budgets and greater efficiency.

Reprioritisation

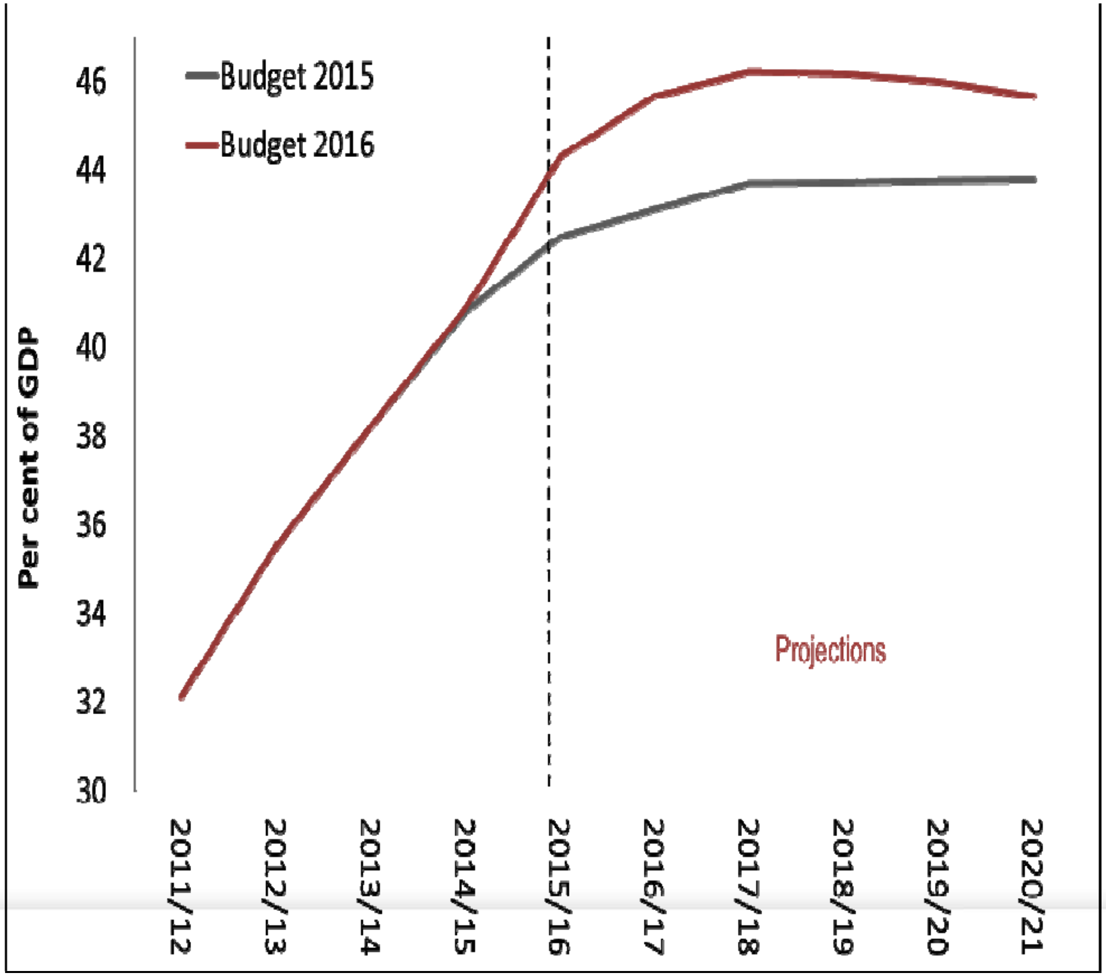
- Reprioritisation of R31.8 billion over the MTEF period to support higher education, South Africa's contributions to the New Development Bank, and for a larger contingency reserve.
- Funding reprioritised away from non-essential goods and services in national departments, compensation budgets of departments with high vacancy rates, and underspending infrastructure programmes.

As a result, national debt stabilises in 2017/18 as a share of GDP

- Net debt is projected to stabilise at 46.2 per cent of GDP in 2017/18, two years earlier than was estimated at the time of the 2015 MTBPS.

- The level of the debt-to-GDP ratio has shifted upwards as a result of lower nominal GDP and the sharp depreciation of the rand, which pushed up the value of foreign debt stock.

Government debt-to-GDP ratio (net of cash balances)



Risks to the fiscal outlook remain, but government is managing them

- **Further deterioration in economic growth**
  - Decline in growth typically results in falling revenue growth, increasing the deficit and debt as a share of GDP.
  - Further increases in interest rates, combined with a weaker exchange rate and rising inflation, would raise the cost of borrowing and increase the stock of debt.
  - › Government is committed to meeting its medium-term fiscal targets and will take additional steps to do so as conditions warrant.

- **Expenditure pressures linked to inflation**
  - Rising inflation would place upward pressure on inflation-linked expenditure, including compensation, social grants and free basic services.
  - › Expenditure ceiling remains in place and budget execution remains excellent, with departments sticking to appropriated expenditure limits.

- **Weak financial positions of several major public entities**
  - Government has acted to stabilise several state-owned enterprises.
  - Eskom, SANRAL, SAA and SAPO being closely monitored.
  - › Future commitments of state will depend on reforms that resolve problems with governance, and may also involve private-sector participation.

Numerous demands on constrained fiscus

- Mandatory social security system (death, disability, retirement, improved unemployment benefits)
- Financing higher education ("fees must fall")
- Universal ECD
- Energy
- Large backlog in roads maintenance and rehabilitation
- Township upgrading
- Sanitation backlogs
- Free basic services

NHI costing

- Three costing models:
  1. Health Economics Unit/PWC (utilisation and unit cost)
  2. McCleod/Grobler (actuarial; costs per beneficiary by age group)
  3. ASSA (actuarial)

- All three models had various scenarios and many assumptions

- But all had scenarios not far off the R255 billion cited in the White paper (10/11 prices) vs R100b-110b baseline

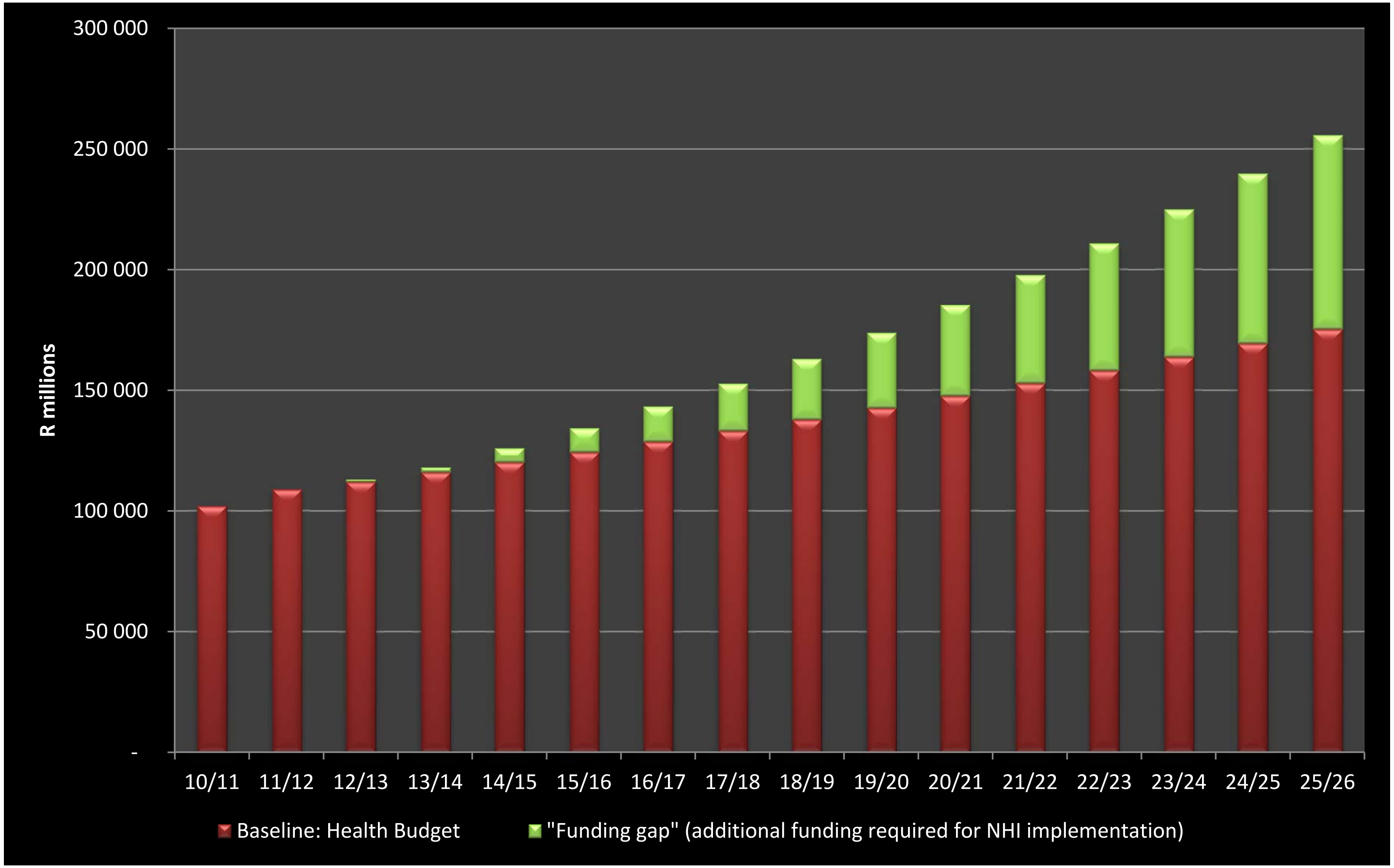
NHI costing (cont.)

- Cost models showed an additional funding requirement of between R70-80 billion by 2025/26, but the projections vary based on the assumptions such as:
  - Pace and phasing of reforms
  - Changing balance between public and private provision
  - <u>Demographic changes</u>: population structure and epidemiological profile
  - <u>Medical inflation over long term</u>: challenges predicting technological change
  - <u>Utilisation</u>: to what extent can this be influenced through PHC, shorter length of stay
  - <u>Unit costs</u>: extent to which private sector is used, wage inflation
  - <u>Benefit package</u>: what is included or excluded
  - <u>Supply side constraints</u>: limited over medium term by practical input and capacity limits

NHI expenditure projections, (real 2010/11) – assume real economic growth rate of 3.5% (real increase in health expenditure)

		Average annual per cent increase	Cost Projection R m (2010 prices)
Baseline public health budget:	**2010/11**		109 769
Projected NHI expenditure:	2015/16	4.1%	134 324
	2020/21	6.7%	185 370
	2025/26	6.7%	255 815
Funding shortfall in 2025/26 if baseline increases by:		2.0%	108 080
		3.5%	71 914
		5.0%	27 613

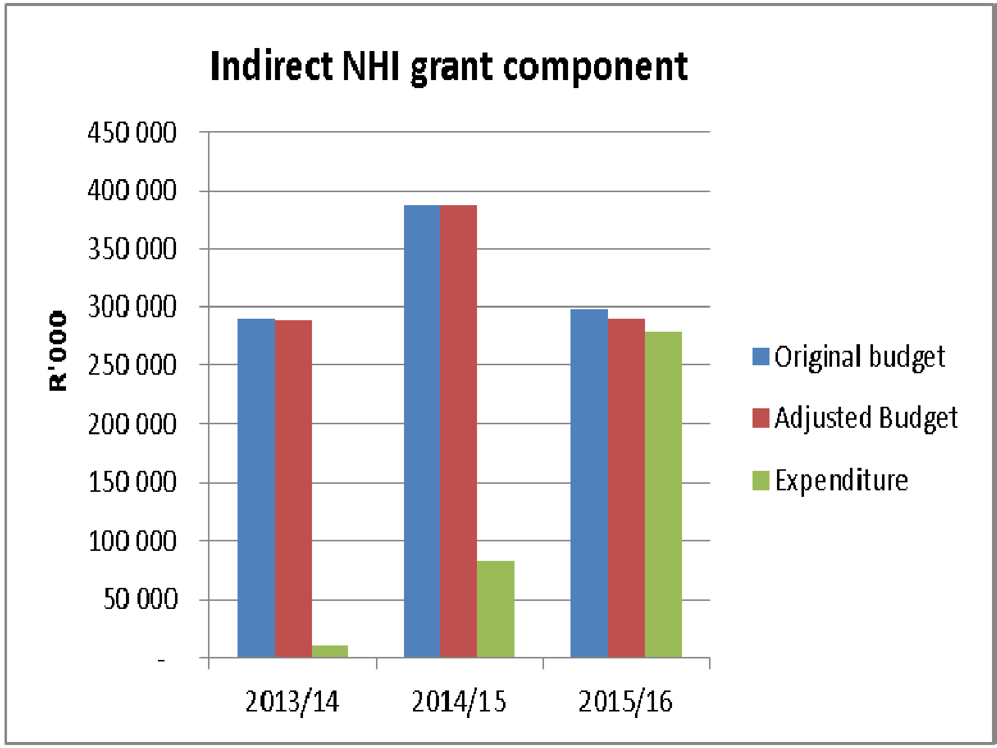
NHI: Funding Requirements

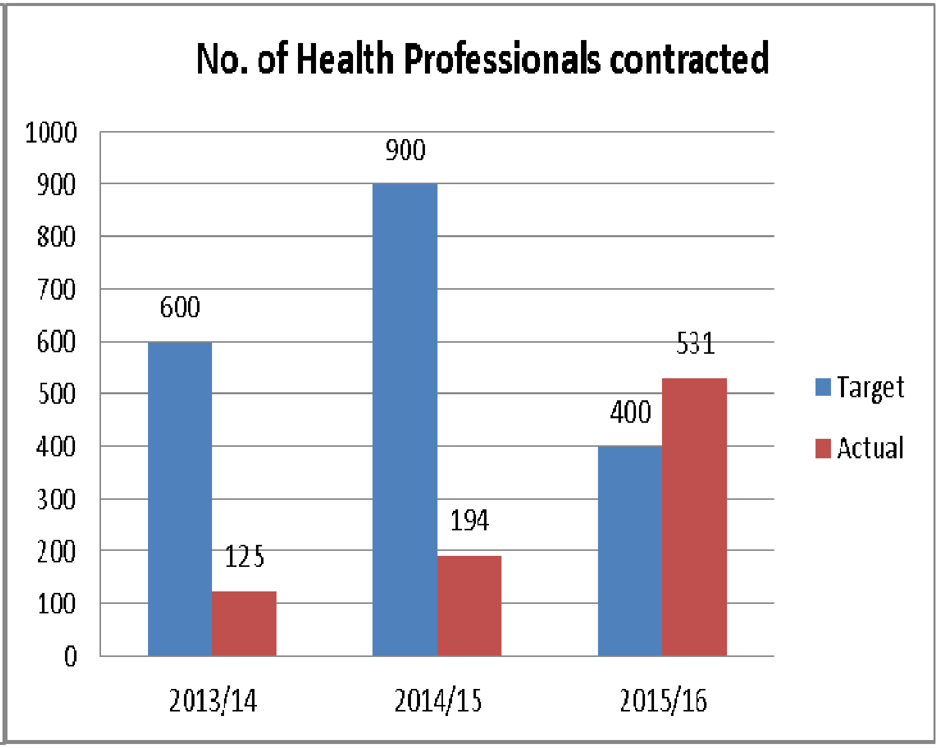


But we may need to revisit the NHI costing

- **Utilisation assumptions not increasing at rate envisaged for both PHC and hospitals:** Even if policy changes implemented by 2025/26, cost increases seem likely now to take much longer e.g. slower changes in utilisation rates
- **Gap between actual MTEF and NHI costing numbers:**
  - Baseline funding increases slower given fiscal environment, so gap to be filled larger if costs not modified
  - Spending and funding assumptions not growing in the way anticipated in models (e.g. R163b in 18/19 (10/11 real prices) vs. R126b-R130b actual
  - Scale-up from R130b (real) in 18/19 to R255b in 2025/26 seems unlikely given spending changes to date
- **Shift out R255b in 2025/26:** Probably sensible to revise cost model and linked tax requirements

Conditional grant performance: Indirect NHI grant component





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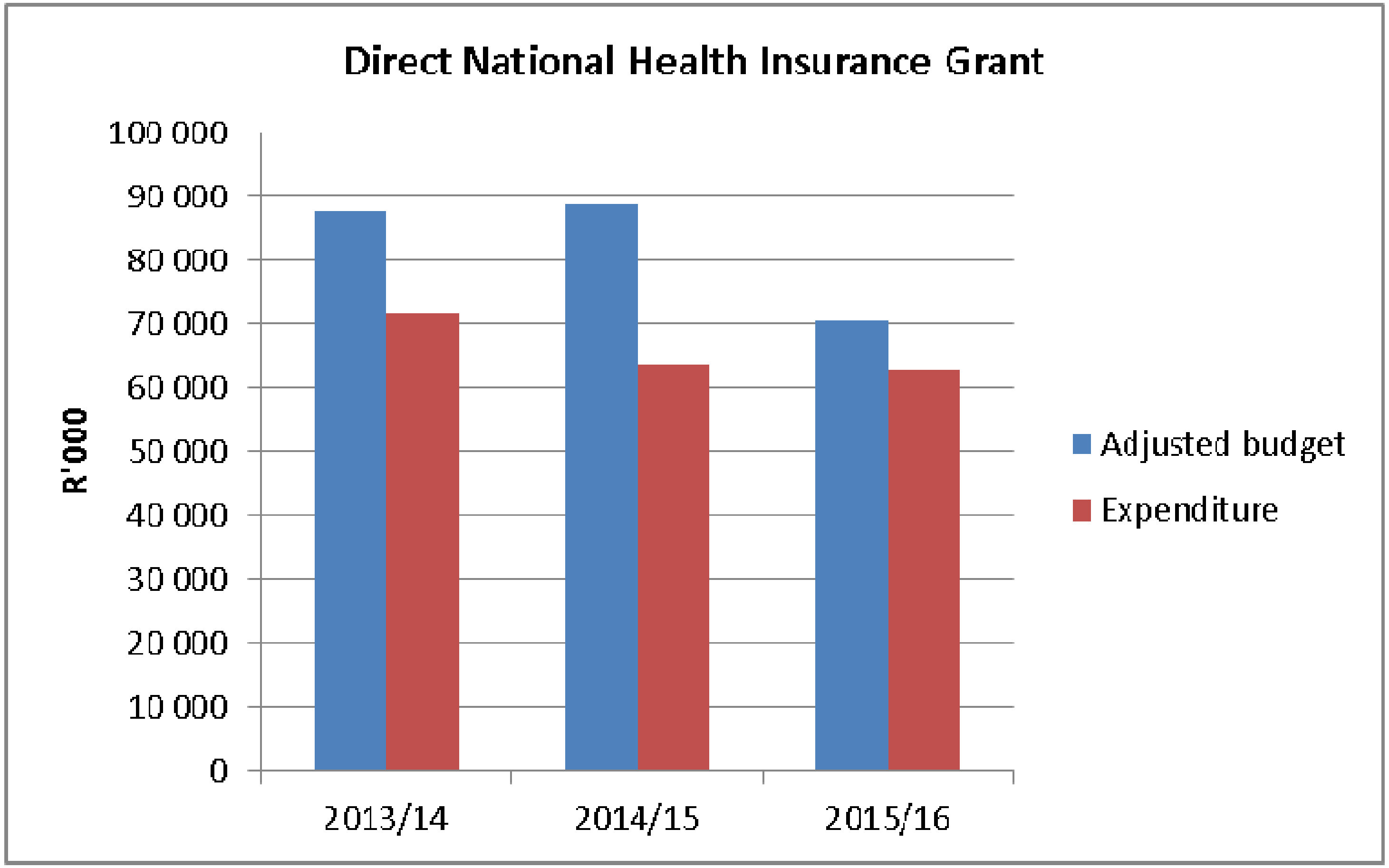
Direct NHI grant to provinces



Proposed health financing reforms

- Revenue raising – mechanisms for raising additional funds for the health sector (proposed options: payroll tax, surcharge on taxable income, VAT)
- Pooling – establishment of the NHIF, reviewing powers and functions across spheres of government, increase cross-subsidisation, virtual pooling
- Purchasing – active purchasing arrangements, purchaser provider split with the envisaged NHIF, contracting, improving info systems for purchasing
  - Restructuring reimbursement mechanisms/incentives (e.g. DRGs, capitation) to reward performance, efficiency, and quality
  - Uncertainties around costs need to be refined through piloting new purchasing models
- Provision – strengthening of public health services, prioritising primary health care, mix of public and private provision could create a whole new ball game for health services in the country, improving quality and accreditation

Potential funding for NHI

- Budget Review 2012:
  - *Over time, the new system [NHI] will require funding over and above current budget allocations to public health. Funding options include:*
    - *Increase in **VAT**;*
    - ***Payroll tax** on employers;*
    - ***Surcharge on taxable income**; or*
    - *A **combination** of the above.*
  - *Achieving an appropriate balance in the funding of national health insurance is necessary to ensure that the tax structure remains supportive of economic growth, job creation and savings.*
- The three tax instruments all have different consequences and careful thought needs to go into adjusting / introducing new mechanisms.

How can South Africa improve value-for-money from its health care spending?

- Supply side measures:
  - Purchaser provider split to improve efficiencies, performance and increase competition
  - *Active purchasing:* Performance based contracting will achieve improvements in health care quality
  - DRG implementation is envisioned to increase competition (cost and quality) within the public sector
- Competition between public and private sector will bring down health care costs and increase health care quality
- Demand-side measures: *PHC reengineering* will encourage healthy lifestyles, improve access to preventative services, reduce disease burden and thus decongest more, expensive higher levels of care

Conclusion

- NHI will necessitate **additional public funding** to the national health budget – could reach R72.0 billion rand in real (2010/11) terms by 2025/26, but significant time has elapsed since previous costing and probably need to revise
- Baseline funding increases slower than projected given **fiscal environment**, so gap to be filled larger if costs not modified
- **Three main revenue options** outlined – (1) surcharge on taxable income / higher personal income tax rates, (2) VAT & (3) payroll tax
- Establishment of **NHI Fund**. Critical aspects and legal considerations
- Way forward on **intergovernmental functions** and linked funding is critical to resolve
- **Active purchasing** including contracting is critical and **capacity** must be built up at district, provincial and national level
- **Mixed public and private provision -** patient choice likely to be important in acceptability of new taxes
- NHI is a long-term path and its success is contingent on **value-for-money** including **cost containment** measures to ensure financial sustainability

ANNEXURES

There are a variety of direct and indirect taxes in South Africa

- **Direct Taxes** (income)
  - Personal Income Tax / Individuals
  - Corporate Income Tax
  - Dividend withholding tax (Previously Secondary Tax on Companies)
  - Estate Duty
  - Donations Tax
  - Payroll Taxes
    - Skills Development Levy
    - Unemployment Insurance Fund

- **Indirect Taxes** ("consumption")
  - Value Added Tax (VAT)
  - Excise Duties (Specific and Ad Valorem)
  - Custom Duties
  - Transfer Duties (Properties)
  - Security Transfer Tax (Financial transactions - shares)
  - Environmentally-related taxes
    - Fuel Levy
    - Electricity levy – non-renewable generation
    - Air Passenger Departure Tax
    - Plastic Bag Levy
    - Tax on incandescent light bulbs
    - CO_2 Motor vehicle CO_2 emissions tax

Tax options under consideration for NHI

Tax	Pros & cons
Surcharge on taxable income: • Personal Income Tax (PIT) system is progressive, marginal tax rates increase - 18% to 40%. • Allows for relatively high tax threshold	• A flat surcharge on taxable income in addition to the PIT liability (similar to the Medicare levy in Australia) could be considered • Administratively feasible • Possible concern is the potential negative impact on savings
Payroll Taxes: • Imposed on employer and/or employee • Current payroll taxes: UIF, Skills development levy (1%)	• Increases cost of employment and incentivizes movement to the informal economy • Consider high unemployment rate in South Africa • Recent global trends show a movement away from this due to the impact on cost of employment, esp. for low & unskilled workers
Value added tax: • Indirect tax • Levied on transactions	• Less distortionary, has a relatively broad base • All those benefitting from NHI would contribute in some way • Does not impact on savings or employment negatively • Impact on the poor – how regressive and how to compensate? • Most VAT revenues from middle and upper income households • SA's VAT rate 14% - compared to global average of 16.4% • Used to fund NHIS in Ghana (majority of funding – 2.5% levy), considering the tax base and future growth in Ghana

Some country examples

- **Australia** (*Medicare*)
  - Mainly funded by general revenue (stable, efficient, equitable and low-cost means of finance)
  - Supplemented by GST, 1.5% Medicare Levy, 1% Medicare Surcharge Levy (without major equity compromises)
  - rebate for private insurance market

- **Ghana** (*National Health Insurance Service*)
  - NHIS is predominantly funded through a 2.5% contribution from VAT
  - This revenue is supplemented by a 2.5% payroll contribution from formal sector and a mix of registration fees and premiums.

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Payroll Taxes: • Imposed on employer and/or employee • Current payroll taxes: UIF, Skills development levy (1%) • Social security reforms in the pipeline	• Increases cost of employment and incentivizes movement to the informal economy • Consider high unemployment rate in South Africa • Recent global trends show a movement away from this due to the impact on cost of employment, esp. for low & unskilled workers • Usually earmarked?
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Cumulative required tax increases for a combination of payroll taxes, surcharge on taxable income & VAT

		Payroll tax	Surcharge on taxable income	Increase in value-added tax
Scenario A: Payroll tax and VAT increase	2015/16	0.5%		0.5%
	2018/19	1.0%		1.0%
	2021/22	1.5%		1.0%
	2022/23	1.5%		1.5%
	2024/25	2.0%		1.5%
	2025/26	**2.0%**		**1.5%**
Scenario B: Surcharge on taxable income	2015/16		1.0%	
	2017/18		1.5%	
	2019/20		2.0%	
	2021/22		2.5%	
	2022/23		3.0%	
	2024/25		3.5%	
	2025/26		**4.0%**	
Scenario C: Surcharge on taxable income and VAT increase	2015/16		0.5%	0.5%
	2018/19		1.0%	1.0%
	2021/22		1.5%	1.0%
	2022/23		1.5%	1.5%
	2024/25		2.0%	1.5%
	2025/26		**2.0%**	**1.5%**
Scenario D: Surcharge on taxable income, VAT increase and Payroll tax	2015/16	0.5%	0.5%	0.0%
	2016/17	0.5%	0.5%	0.5%
	2021/22	0.5%	1.0%	0.5%
	2022/23	1.0%	1.0%	0.5%
	2024/25	**1.0%**	**1.0%**	**1.0%**

Pooling: formation of NHI Fund

- Establishment of the NHI Fund: fairly straight forward as Schedule 3A public entity
- Could be formed initially building on several conditional grants that fund personal health services e.g. NTSG grant (R14b), HIV and TB grant (R20b), indirect NHI grant, new ideal clinic component and new funds
- Organisation and governance of the NHI Fund
- Could be introduced within 3 years
- This is the easy part

Pooling: inter-governmental location of functions and funding

- This is the more difficult part
- Reviewing powers and functions across spheres of government (funds follow function)
- <u>**Five main options:**</u>
  - Function shift – centralisation e.g. central hospitals
  - Shared functions e.g. PHC (NHI as a supplementary funding stream over and above PES)
  - Centralisation and delegation
  - Provincial funds
  - Constitutional change
- These options have huge implications
- Until this is settled and with provinces, difficult to move on several other issues

Purchasing

- **<u>Key set of issues for NHI systems:</u>**
  - Separation of purchaser from provider
  - Reimbursement reform: DRGs, capitation
  - Contracting: information systems
  - Contracting with public and private providers
  - Pricing of services to bring in a diverse mix of public and private providers
- Very little piloting of purchasing reforms to date in pilot sites. This is a problem because purchasing reform is central to NHI and we have little sense of unit costs, what kind of contracts will work, etc. Would like to see more attention on these areas

Provision

- Necessary to get clearer sense of future envisaged mix of public and private providers and how this will be rolled out
- Current contracting of GPs in pilot sites is a sessional employment model, not an independent practice model as in most NHI systems
- To raise specific new taxes for NHI, users need to understand and value improved services and benefits they will be receiving
  - Strengthening public health services
  - Improving quality and accreditation