Report prepared for DHB Shared Services

Annual statement of reasonable GP fee increases - 2016/17 update

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sapere research group

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Sapere Research Group is one of the largest expert consulting firms in Australasia and a leader in provision of independent economic, forensic accounting and public policy services. Sapere provides independent expert testimony, strategic advisory services, data analytics and other advice to Australasia's private sector corporate clients, major law firms, government agencies, and regulatory bodies.

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Executive Summary

This report contains the 2016/17 update of the annual statement of reasonable GP fee increase. The reasonable patient co-payment increase in 2016/17 for a practice that derives half of its income from government sources and the other half from fees is **1.25 per cent**.

This figure is based on a weighted average increase in input costs of 1.12 per cent (up slightly from 1.10 per cent last year) and a government funding adjustment of 1.0 per cent (up from 0.8 per cent last year).

Reasonable co-payment increases based on alternative government/co-payment practice revenue shares are as follows:

- 60/40: 1.31 per cent
- 70/30: 1.42 per cent
- 80/20: 1.62 per cent

1. Introduction

1.1 Purpose of the annual statement

This report presents the update of the annual statement of reasonable GP fee increase for the 2016/17 period.

1.2 Background

In 2006, a project team from LECG Asia Pacific (now renamed Sapere Research Group) was commissioned by DHBNZ to develop a methodology for setting the annual statement of reasonable GP fee increases. The team worked under the guidance of an Advisory Group, involving representatives from DHBs and the primary health care sector. Once the methodology had been developed, Sapere produced the first annual statements relating to the 2005/06 and 2006/07 June years. Subsequently, Sapere has produced further update reports on an annual basis for DHBNZ (now called DHB Shared Services).

Further background on the application of the annual statement and the processes within which it is used can be found at:
http://www.dhbsharedservices.health.nz/tools/search.aspx?SECT=Site

2. Recap of methodology

2.1 Indices used

Calculating annual fee changes is driven by weighted average changes to prices of three key inputs used to produce the services provided by GPs. Together the three indices provide measures of the extent to which changes in business input costs put pressure on the output prices charged for goods and services.

2.1.1 Labour Cost Index

The price of labour is a major driver of potential changes in operating costs and hence the fees charged by practices. The measure used is the *Labour Cost Index – All Salaries and Wage Rates* (LCI), which gives a measure of movements in the cost of labour. The index covers jobs filled by paid employees in all occupations and in all industries except for private households employing staff. As outlined further below in clause 2.2, the component of the LCI used in the calculation process is that which is deemed most relevant to the provision of primary care services (i.e. Health Care and Social Assistance).[1]

2.1.2 Producer's Price Index

The *Producer's Price Index - Inputs* (PPI-I) is a measure of the change in prices of items such as: materials; fuels and electricity; transport and communication; rent and lease of land; building, vehicles and plant; commission and contract services; business services; and insurance premiums less claims. It excludes labour depreciation costs and GST. The relevant component of the PPI-I used for this exercise relates specifically to the Health sector (previously known as Health and Community Services).

2.1.3 Capital Goods Price Index

The *Capital Goods Price Index* (CGPI) is a measure of the change in the general level of prices for physical capital assets (for example, buildings). It excludes large value items (such as aircraft) and second-hand equipment. The relevant components of the CGPI used for this exercise relate to Non-residential Buildings and Plant, Machinery and Equipment.

2.2 Annual statement calculation

As described in previous reports, the process of calculation takes place sequentially, involving two components- the change in input costs component and the change in

[1] Note that this category was previously referred to as Health and Community Services, both in the LCI itself and past annual statement updates. It is a name change only. We note that Statistics New Zealand is currently reviewing the weights used to construct the LCI. The intention of such a reweighting exercise is to ensure that the index remains "fit-for-purpose" over time (i.e. to reflect changes in the way resources are used). Our assessment is that the effect of such a reweighting will be similar to the re-basing that took place previously. It will make comparison with previous years difficult, but will still reflect the important and relevant cost factors used in our calculations. We will comment further in any subsequent reports, once the reweighting exercise is complete.

capitation-based Government funding received (i.e. First Contact funding). The latter was previously known as the Future Funding Track (FFT) and has also previously been referred to as a "cost pressures adjustment."

The first step involves determining the annual percentage change for the relevant components of each index and averaging over the previous 12 months.

Following this, we apply weightings previously agreed by the Advisory Group to the respective indices. These weightings remain unchanged from those utilised in previous years: 70 per cent labour (LCI); 20 per cent other inputs (PPI-I); and 10 per cent for capital (5% for each component of CGPI).

Using this weighted average we assess the effect of input cost changes on total fees (i.e. GP fees in the absence of capitation payments). From this, we use the known Government funding contribution to derive the reasonable level of co-payment increase.

We use the March, June, September and December quarters of the preceding calendar year for these calculations.

3. Changes in indices

3.1 Data sources

All data used in the production of this statement has been sourced from Statistics New Zealand. The relevant files can be accessed directly from the Statistics New Zealand website[2].

3.2 Overview of trends across indices

A summary of movements in relevant indices is provided below in Table 1. The annual change in the Health Care and Social Assistance component of the LCI between the March and December quarters for 2015 was below the average for all industries combined in calendar year 2015.

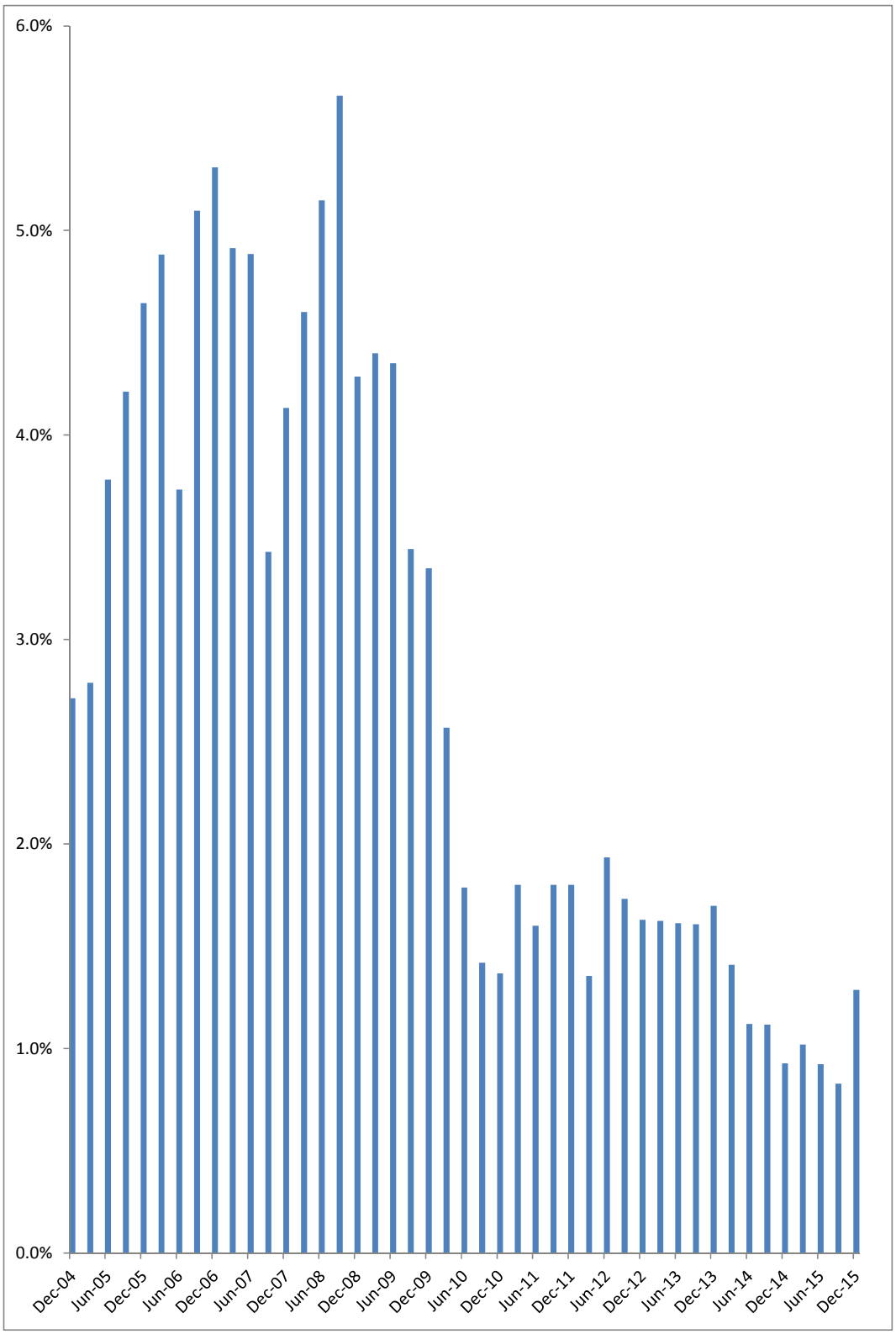
Table 1: Index movements up to December 2015 quarter

Index	Change from previous quarter (from September 2015 qtr)	Change from same quarter previous year (from December 2014 qtr)
PPI Inputs Health	-0.1%	0.6%
LCI Health Care and Social Assistance	0.6%	1.3%
CGPI Non-residential Buildings	0.5%	3.2%
CGPI Plant, Machinery and Equipment	0.7%	3.6%

Figure 1 shows the annual per cent change for each quarter in the LCI since December 2004. As shown, the last few years have been relatively steady in terms of annual changes, but are well below historical averages prior to 2010. Given the relative weighting of the LCI to the other indices, changes to this index have a significant effect on the overall fee increase calculations.

[2] http://www.stats.govt.nz

Figure 1: Annual percentage change in LCI



4. Calculation of the annual statement

4.1 Step 1: Input-cost related adjustment rate

Using the process outlined in section 2.2, we generate a total fee adjustment rate of **1.12 per cent** for 2016/17. This weighted average figure represents the **input-cost related change** to the total fee for a given year, a crucial intermediate input into the annual statement determination. Given relative weightings, it is closely related to the LCI.

Table 2 below provides the equivalent input-cost related adjustment factors for this and previous years.[3]

Table 2: Input-cost related adjustment rate

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Input-cost adjustment	3.9%	4.4%	3.7%	4.8%	3.01%	1.09%	1.41%	1.50%	1.18%	1.10%	1.12%

4.2 Step 2: Adjustment for Government funding and calculation of annual statement

The Ministry of Health advise that a Government funding adjustment of 1.0 per cent will apply this (fiscal) year to first level (first contact) services. Table 3 shows how this adjustment compares to previous Government funding adjustments.

This adjustment is combined with the findings from the previous step to determine the reasonable increase to co-payment levels.

[3] Note that the information in this table is illustrative only. The time period changes implemented in 2009 mean the 2010/11, 2011/12 and 2012/13 figures are not directly comparable with the previous figures. In addition, the LCI was re-based from a June 2001 base to a June 2009 base. Similarly the PPI-I was rebased from a December 1997 to a December 2010 base. Therefore, values contained in past annual statements are not able to be directly compared with the current values.

Table 3: Annual percentage change in funding for First Level (First Contact) Services

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Govt adjustment	3.3%	2.6%	2.8%	3.1%	2.0%	2.0%	1.49%	1.0%	1.0%	0.8%	1.0%

As shown in Table 4 below, **based on a 50/50 capitation/co-payment revenue split**, the reasonable fee (patient co-payment) increase for 2016/17 is **1.25 per cent**.

Table 4: Annual levels for reasonable increases to GP patient co-payments

50/50 split	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Reasonable fee increase	4.5%	6.1%	4.7%	6.5%	4.02%	0.19%	1.34%	2.01%	1.37%	1.40%	1.25%

This value is a function of the relativity between (capitation/first contact) funding from the Government and the input-related adjustment factor for the total fee, given an assumed split.[4] When the Government-generated adjustment is greater than the input-related adjustment factor, the co-payment increase will be less than the input-related adjustment factor.[5]

Alternative capitation /co-payment splits

Various practices and practice groups may have different splits based on their total revenue from both sources.

Table 5 below provides the annual statement change for various capitation/co-payment splits, compared with the equivalent figures for previous annual statements. Note that figures prior to the 2010/11 year were calculated using a different time period, so are not directly comparable with this year's figures.

[4] The fee template associated with the annual statement gives the opportunity to use practice, or practice group specific data where this split is not appropriate.

[5] This is because the effective weighting attached to the capitation subsidy is greater than that of the co-payment, meaning that when the capitation adjustment is greater than the input-related adjustment factor, there is effectively less work to do by the co-payment in order for the total fee adjustment to match the change in costs faced by practices.

Table 5: Annual statement and general adjustments for different capitation/co-payment splits

		2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Level of reasonable patient co-payment GP fee increase	Assuming: **80/20 split**	6.3%	11.4%	7.5%	11.5%	7.05%	-2.53%	1.11%	3.52%	1.92%	2.31%	**1.62%**
	70/30 split	5.3%	8.5%	5.9%	8.7%	5.37%	-1.02%	1.24%	2.68%	1.61%	1.81%	**1.42%**
	60/40 split	4.8%	7.0%	5.1%	7.3%	4.53%	-0.26%	1.30%	2.26%	1.46%	1.55%	**1.31%**
	50/50 split	4.5%	6.1%	4.7%	6.5%	4.02%	0.19%	1.34%	2.01%	1.37%	1.40%	**1.25%**