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Blood Money:

Paying for pathology services

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Overview

Pathology tests are an essential part of modern medical care. They assist doctors to make or confirm a diagnosis so that they can advise on the correct treatment for a patient's condition.

Patients, health insurance funds and taxpayers spend a lot of money to get these benefits. Government, through Medicare, spent $2.5 billion on pathology services in 2014-15.

Medicare-billed pathology services are mostly provided by the private sector. When private companies provide public services it is expected they can deliver services more efficiently than government, costing taxpayers less.

Australian pathology is certainly efficient. The industry's pursuit of process automation has led to ever-cheaper ways of delivering services. Thanks to market consolidation, two publicly listed firms now control more than 75 per cent of the market.

But taxpayers have seen minimal benefit from these developments. The way Australians pay for pathology services has hardly changed in the last fifty years. We pay as if testing was still done by thousands of small providers manually processing tests, and not by two industry giants with automated services.

As the Minister for Health recently noted, Medicare is not meant to provide guaranteed revenue for corporations. But pathology companies don't seem to agree. Negotiated caps on spending have been exceeded by industry for the last four years in a row. And when government wants to change policy settings, companies threaten to shift costs to consumers, as they did recently in response to the 2015 Mid-Year Economic Forecast and Outcomes statement. There is a better way.

First, the way we pay for pathology can be improved to allow government – and taxpayers – to share in the massive efficiency savings that the industry currently keeps to itself.

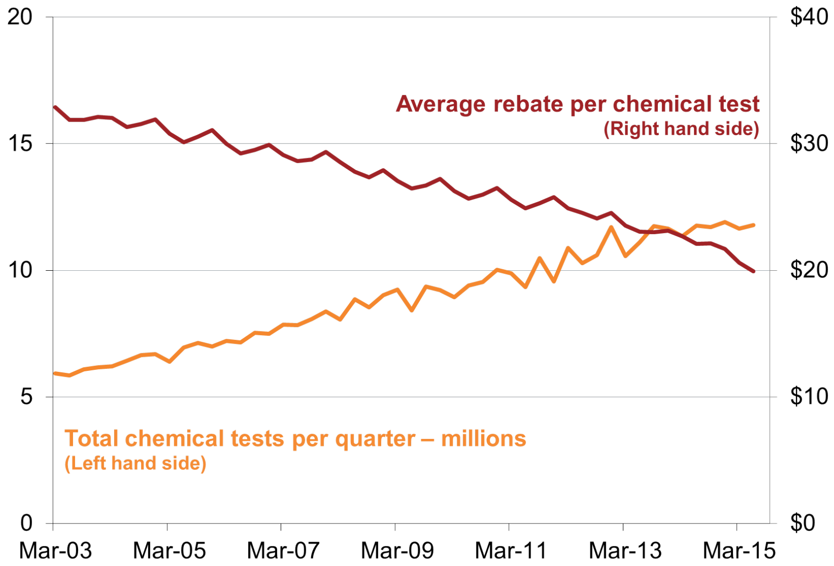
Second, patient co-payments for tests should be abolished. Patients aren't the real consumers of pathology tests – the doctors who order and use them are. There is little point in co-payments if they don't improve care but in fact punish the sick, while enabling industry to use the threat of co-payments as a bargaining chip in policy battles.

Third, government could experiment with introducing price competition into the market. Companies could tender for contracts to provide the majority of pathology services in certain areas, provided they charge government less than the rebate and without adding co-payments. Public hospitals could also compete. Such a scheme could be piloted in Victoria from 2017.

These reforms could save government at least $175 million annually. The savings come from narrowing the margins of profitable corporations, not from cutting services to the ill and vulnerable. In a time of increasing deficits, government must prioritise reforms that reduce spending without compromising the health of Australians. This opportunity should not be missed.

Figure 3: Reduced average rebates capture less than half of cost savings from increased test volume

Tests in millions (LHS) and average rebate per test (RHS)



Notes: Rebates adjusted for inflation using series A2331115L in Table 11 of ABS Catalogue 6401.0.
Source: Grattan Institute analysis of Medicare pathology services group statistics - Department of Human Services (Commonwealth) (2016a)

Figure 3 shows that since March quarter 2003 the number of Medicare-billed chemical pathology tests increased around 100 per cent. Rebates per test declined around 40 per cent in real terms, principally as a result of other changes to the pathology schedule.

The increase in the number of billed tests probably resulted in lower costs per test for pathology providers due to economies of scale, such as, for instance, more intense use of existing equipment. Most of the benefits of the reduced cost per test were captured by the pathology corporations, with government (and taxpayers) receiving little of the benefit of increased test volumes.

Fixed pricing per test means that providers accrue all the benefits of the volume-related decline in cost, resulting in greater profits for greater volumes. As a result, pathology businesses appear to be quite profitable, with returns of around 13-15 per cent.[20]

Technological change has had different impacts on different types of pathology tests. This means that relative prices in the current schedule no longer represent contemporary cost relativities.[21] In those sections of the schedule which are now highly automated (e.g. chemistry), the marginal or incremental cost of performing additional tests is trivially small relative to the rebate, which is set at full average cost. Pathology companies are able to cross-subsidise from one type of test to another, this can create problems with niche providers.

Total cost of pathology services also include the cost of collecting specimens, which is paid through Patient Episode Initiation fees. Competition for market share potentially leads to pathology corporations paying relatively high prices to other medical practitioners to co-locate their collection centres.

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[20] Returns derived from Grattan Institute analysis of company annual reports. The proposals in this report would reduce revenue for pathology businesses and encourage companies to drive efficiencies through consolidation or further automation.
[21] New tests added to the schedule generally have fees more closely aligned to costs.

The private pathology lobby group, Pathology Australia, argues that its members are paying inflated rents for co-located centres, estimating the excess costs at $200 million per year.[22]

Prices paid for collection centres by pathology companies is a business decision, with potentially inflated prices traded off by the companies as part of their quest for market share and volume. Where the pathology company is also involved in primary medical care, the excess is simply an inter-company transfer.

Rental prices for collection centres are regulated by the Health Insurance Regulations which provide that rents cannot be more that 20 per cent above market rental.[23]

The prices paid for collection centre rentals have been described as a 'nice earner' for general practitioners,[24] and are now incorporated into income flow expectations of general practitioners, partially offsetting the freeze on general practitioner rebates. Any government review of the rental arrangements should be within this wider general practice context.

The fact remains, though, that the prices paid by pathology corporations are commercial decisions and it is disingenuous for the pathology industry lobby group to complain about the commercial outcomes that their members negotiated. The excess prices paid by the industry might also be a place for industry to examine in making the savings identified in this report.

[22] Pathology Australia (2015)
[23] Regulation 20CA
[24] Arnold (2012)

1.3.2 Cost to government – total spending

The total cost to government depends on the price of each test and how many tests it pays for.

A major focus of government pathology payment policy has been to moderate spending through negotiated deals with industry formalised in the Pathology Funding Agreement.

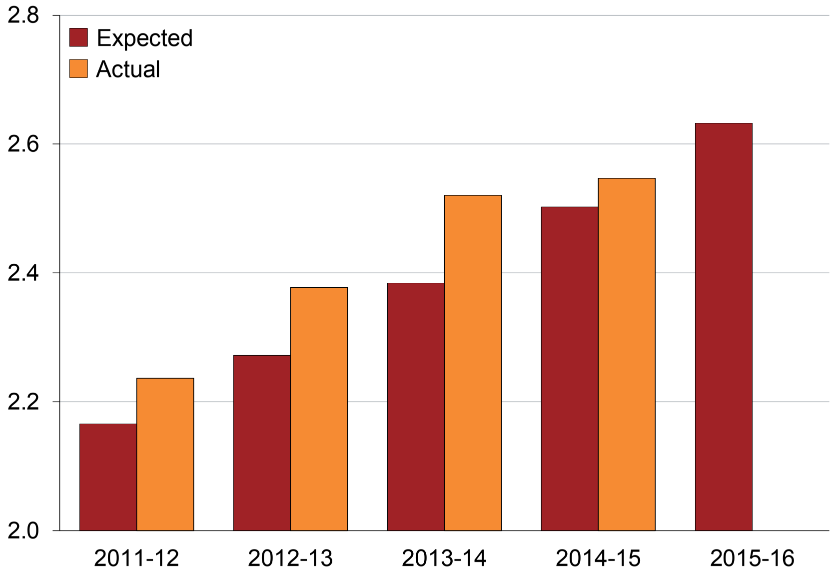
The current Agreement covers the period July 2011 to June 2016.[25] One of the key objectives of the Agreement is to 'promote value for money' for government outlays, and it includes agreed ranges of expected expenditure on pathology services (targets).

The Pathology Funding Agreement does not guarantee that either the base prices to be paid for pathology items, nor the indexation arrangements, will result in the most efficient prices being paid.

[25] The 2014 Commonwealth budget included provision for pathology co-payments. Although these changes did not proceed, they effectively overturned the Agreement and it is understood that no work on the Agreement has been undertaken since then.

Figure 4: Costs are increasing faster than the targets set in the Pathology Funding Agreement

$, Billions



Sources: Pathology Funding Agreement (2011) and Medicare benefit data from Department of Human Services (Commonwealth) (2016a). Expected expenditure is not adjusted for any Government policy changes.

Further, the targets set in the Agreement have not been achieved, with overruns of 1 to 5 per cent each year (see Figure 4). The cumulative overrun in the first four years of the current five year Agreement is $357 million.

The Agreement has a series of let-out and dispute resolution clauses which make management of the Agreement complex. For example, the Agreement provides that 'reconsideration' of the outlay targets may occur if Medicare consultations increase by more than 3.5 per cent where there are 'demonstrable flow-on effects to pathology requesting'.[26]

The previous Agreement had similar problems with overruns. The agreed rate of expenditure growth in that Agreement, for instance, was 5.3 per cent, whereas actual growth was 7 per cent.[27]

The pathology lobby groups have commissioned reports from consulting companies to explain why the negotiated Agreement caps have been exceeded, generally arguing that government policy or other external factors justify the overruns.[28]

In fact, the escalation provisions in the Pathology Funding Agreement were generous compared to similar policies internationally (see Chapter 2). In Canada, for example, the Ontario equivalent arrangement has been capped for many years. The Alberta contract provides for escalation which barely covers population growth and inflation.

1.4 The right cost?

The process of setting pathology rebates is opaque, despite a clause in the Pathology Funding Agreement which committed the Government and the pathology industry to work towards developing a transparent fee-setting mechanism.[29] Industry has

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[26] clause 14 a
[27] Auditor-General (2008)
[28] KPMG Econtech (2011)
[29] Clause 21: *The Parties to this Agreement agree to contribute to developing a more transparent mechanism for setting and reviewing (pathology) schedule fees…, based on better cost information, such as direct costs of individual tests, the indirect costs (overheads) related to providing tests, the costs of collection,*