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GO BUSH BUT PAY THE PRICE

Location-based subsidies make no economic sense

PAUL KERIN

The Australian's front-page headline last Tuesday — "Bigger health rebates in bush" — flagged a proposal that would generate yet another government-mandated subsidy to individuals based on where they choose to live.

However, we'd be much better off overall if our governments stopped paying location-based subsidies altogether.

Location-based subsidies are pervasive and substantial. Most are cross-subsidies (from residents of certain locations to those of others). For example, as a South Australian, I'm very grateful to the majority of this newspaper's readers who contribute to the $1.8-billion-a-year GST cross-subsidy that SA enjoys — but I have to admit it is plain silly. If a state with a population of 1.7 million can't float on its own bottom, there's something seriously wrong.

The Productivity Commission recently "conservatively" estimated that federal government policies that aim to ensure that telecommunications services are "available, accessible and affordable" to "geographical areas or cohorts" that are "high cost and uneconomic to serve" generate subsidies of over $1bn a year, much of which the commission describes as "past its use-by date".

The previous Labor government mandated substantial cross-subsidies from NBN customers in low-cost locations to those in high-cost locations. While the Turnbull government is reviewing this, significant cross-subsidies are likely to remain. Cross-subsidies are rife in utilities. For example, in SA, government-mandated uniform state-wide pricing generates substantial cross-subsidies from metropolitan to country water users.

These are but a few examples.

Why are location-based subsidies problematic? They distort our choices. Adam Smith's invisible hand theorem — that the public interest is best served by letting individuals make voluntary choices to exchange goods and services — applies to location choices too. But they also distort other choices. For example, SA country residents have incentive to use water even when it benefits them less than the real supply costs, while metropolitan residents use too little water (the benefits they'd enjoy from addition usage would exceed the real supply costs). The invisible hand only works if we all receive price signals that reflect the real costs of our choices.

We'd be better-off if we all make our own choices as to where we live and work — and if governments and private providers choose the services to supply in different locations — based on the sensible real benefit/cost trade-offs.

Prices in high-cost locations should be higher, not artificially offset by subsidies. Take SA electricity prices. Sure, daft federal and SA government policies contributed to the current mess, but fundamentals mean that SA should have Australia's highest electricity prices anyway. The combination of low population density (which drives high network costs per customer) and climate (which drives air conditioner use, giving SA the peakiest — and therefore most expensive to serve — demand profile) means that the real costs of providing electricity in SA are inevitably higher. These costs shouldn't be disguised. It's important that we South Australians face prices that reflect the real costs so that we have incentives to carefully manage our usage.

But what outcomes would we expect if we applied sensible benefit/cost trade-offs to healthcare and insurance? It's a fact of life that the costs of providing many services — including healthcare, telecommunications and utilities — are strongly driven by population densities and/or scale. Therefore, supply costs are unavoidably higher in rural/remote areas. Hence, we'd expect relatively few private service-providers in rural/remote areas and rural/remote residents to rely relatively more on publicly provided services and/or have to travel further to access private providers. Consequently, we'd expect rural/remote residents' private health insurance uptake to be lower, as they'd access private services less and/or incur higher costs to do so.

Yet Health Minister Sussan Ley is concerned about private health insurance uptake in rural/remote areas (50 per cent), even though it isn't much lower than in metropolitan areas (60 per cent). And a recent workshop held by her advisers cited as "critical issues" lack of access to services or choice of providers and the cost of travel and accommodation to be treated elsewhere.

But as we've seen, the minister's concern and the workshop's critical issues are exactly the byproducts we'd expect if we all made sensible benefit/cost trade-offs. Forcing private health insurers to pay higher rebates to rural/remote customers is a solution in search of a real problem. And it has downsides. For example, it would inevitably generate cross-subsidies as insurers raise premiums and/or cut benefits for other customers. This would encourage some customers in low-cost areas to drop their private health insurance.

There are plenty of government-mandated cross-subsidies that aren't location-related and they should be reviewed too. For example, under our mandatory community rating system, health insurers can't charge differential premiums based on health status or claims history. As a long-term Type-1 diabetic, I enjoy a large cross-subsidy under this system. But maybe we should abolish it (while protecting individuals' rights to pre-agreed insurance and premiums if their health deteriorates). If we did, health insurers would do a "youi" — tailor insurance premiums to individuals' specific circumstances. If rural/remote citizen residents use private services less, they (and other low users) would get cheaper health insurance. If we really want rural/remote residents or young people to adopt private health insurance, removing community rating would do it.

Of course, we should ensure that all citizens have access to a safety net that provides an acceptable standard of living (including medical care) — but based on need, not location. Direct means-tested assistance is the best way to do that.

Even if we don't abolish location-based subsidies, we should change how they're calculated. For example, a state' share of GST revenues rises with its relative population growth. I freely chose to return from Melbourne to my home state of South Australia six years ago. You shouldn't have to subsidise the SA government more because of my free choice, but you do!

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