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Obstacles in the Development of Nonprofit Hospitals in Georgia

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ABSTRACT

The most common form of ownership of medical establishments worldwide is a nonprofit organization. In contrast, the number of nonprofit medical institutions in Georgia is very scarce, while private profit organizations hold about 90% of the medical market. The goal of the research is to study the factors that affect the development of nonprofit hospitals in Georgia. Since there are very few nonprofit medical institutions in Georgia, we hypothesize that there is not enough motivation for functioning of such institutions. For the purposes of this research, six in-depth interviews were conducted with managers and experts of nonprofit organizations. As the research demonstrated, there is no sufficient motivation for functioning of the nonprofit form of medical organizations. Although the Tax Code provides tax benefits, they exist only in a token way and do not support the development of nonprofit medical organizations. It is necessary to improve the tax benefits provided for nonprofit hospitals in the Tax Code and share the world experience in order to increase number of nonprofit organizations in Georgia. It is recommended for Government to give more support to nonprofit organizations, in order to increase their functioning efficiency and bring incentive for development of new nonprofit medical institutions.

KEYWORDS

commercial hospitals; healthcare; hospital ownership; nonprofit hospital

Introduction

The essence of nonprofit hospitals

The health care market substantially differs from that of the other markets. Therefore, the behavior of health care providers operating in the health care market is different. This difference is related to the form of ownership of medical organizations. In contrast to solely profit oriented markets, healthcare market deploys several forms of ownership of the medical organizations: nonprofit, for-profit, state-owned, public-private partnership.

The most common form of ownership of medical organizations is a noncommercial (nonprofit) organization. The term “nonprofit organization” is often misinterpreted and defined as an organization that does not carry out the profitable activity. In fact, nonprofit institutions as well as profit, or public medical institutions are seeking profit. Private profit and nonprofit medical organizations differ from each other by the

mechanism of distribution of profit. In particular, in nonprofit hospitals, unlike profit hospitals, profits are not distributed to the owners or shareholders. Nonprofit hospitals are managed by the boards which are composed of doctors and community representatives. The profit received by such hospitals is used for: improving the quality of medical services, purchasing the new diagnostic equipment and increasing wages for the medical personnel (Harrison and Sexton 2006; Feldstein 2011).

The predominant development of nonprofit hospitals is seen in European countries as well as in the USA. Noncommercial medical organizations in European countries constitute more than 70-80% of all medical organizations, while in the United States they account for only 57% (AHA 2007).

Contrary to the world experience, there are only two forms of ownership of medical organizations in Georgia: 88.6% of the hospitals are private for-profit organizations (42% are owned

by the insurance companies, 29% - by individuals, 18.4% - by other types companies) and 8% are state-owned (Boer 2012; Verulava, Jorbenadze and Barkalaia 2017).

Factors contributing to the development of nonprofit medical organizations

The establishment of nonprofit hospitals, dates back to middle Ages, where their establishment in European Countries and the United States was linked to religious organizations and local community associations (Kelley 2005). Nonprofit organizations played a big role in helping poor people, orphans, and tuberculosis patients (Clotfelter and Ehrlich 1999). This impoverished segment of population did not have proper sanitary-hygienic conditions for in-home treatment and, therefore, required hospital accommodation. In contrast, the nobles were able to employ court doctors and, consequently, were not in the need for the hospital services (Horwitz and Austin 2009). Hence, in European countries and in the United States, nonprofit hospitals were established to provide healthcare services for the poor, the most important source of funding of which were charitable donations (Bolon 2005; Hayden 2005).

The development of medical technologies at the beginning of the 20th century contributed to the formation of a hospital as it is today (Starr 2017). The emergency clinics as well as hospitals, medical and rehabilitation centers were established. As a result of new medical technologies the role of hospitals has changed (Cutler 2000; Sloan et al. 1990). The hospital became the place for medical staff's activity, treatment of patients on the proper level (Arrow 1963).

Along with change in functions of hospitals, the financing mechanisms of hospitals have also been transformed. If previously the charitable foundations and donations were a major source of hospital's revenues, in the later period the share of public spending, as well as the state and private insurance increased (Pauly 1987). Thus, charitable hospitals turned into nonprofit, i.e. noncommercial hospitals.

The state support played a big role in the development of nonprofit hospitals in the western

countries (Becker and Frank 1985). As nonprofit hospitals serve poor and low-income patients, their activities are considered as charitable. Accordingly, their income and property are mainly exempt from state taxes (Arrow 1963). The public has put a lot of confidence in nonprofit hospitals in Europe and United States (Folland, Goodman and Miron 2007). On the medical markets, where consumers are less informed and do not have relevant education about the needs of healthcare services, special importance is given to the trust-based relationships (Horwitz 2005). Patients prefer nonprofit hospitals because the term "profit" for them is a signal that denies a relationship based on trust (Norton and Staiger 1994). Consequently, patients are more likely to trust nonprofit hospitals, since such hospitals are not solely focused on the profit (Hansmann 1980; Gruber 1994).

In addition, the nonprofit hospital's work is overseen by a community and the doctors have more opportunity to independently determine the hospital policies, acquire the necessary medical equipment, and in contrast to the profit hospitals, to deliver expensive services to patients at low cost (Frank and Salkever 1994). Consequently, nonprofit hospitals are more likely to fit physicians' financial interests (Walker 2005; Verulava et al. 2018a).

The fact that private nonprofit organizations are popular is demonstrated by the fact that, in the USA, 70% of patients refer to nonprofit hospitals, and only 13% of patients refer to profit hospitals. Medical personnel prefer to work at nonprofit hospitals (AHA 2007; Duggan 2000).

According to the widespread public opinion, private profit organization is always associated with better quality of medical care (Clement, Smith, and Wheeler 1994; Deneffe and Masson 2002). However, research shows that there is no significant difference between profit and nonprofit hospitals in terms of quality of healthcare services (Cabin 2016; Verulava et al. 2018b).

Development of nonprofit health care organizations in Georgia

In the nineteenth century and early twentieth century, many Georgian philanthropists

established nonprofit hospitals. In Tbilisi, the infirmary at the St. Andrew the First Called Cathedral and the St. Nino's infirmary were nonprofit medical organizations. The main source of their financing were the secular and ecclesiastical donations. In 1903, the famous patron of the arts and philanthropist Mikael Aramyants (1843-1923) donated 100,000 rubles to the construction of the Hospital in Tbilisi, which eventually opened in 1909 and functioned as a nonprofit clinic until 1921. The hospital equipment, salaries of medical personnel or other expenses were paid by the philanthropist himself. The brothers Zubalashvili (a family of businessmen and benefactors) built the first children's hospital in Tbilisi in the 80s of the 19th century and gave it to the city free of charge (Verulava, Jorbenadze and Dangadze 2018).

Since 1921, as a result of Georgia's Soviet Occupation, nonprofit hospitals were transformed into state-owned medical organizations. Accordingly, only one form, the state ownership of medical organizations was developed in the Soviet period. After restoration of independence, most of the state-owned hospitals were sold and transformed into private profit hospitals in the 1990s (Asatiani and Verulava 2017; Verulava and Maglakelidze 2017). Thus, since the Soviet period, nonprofit health care organizations in Georgia could not have been developed.

The goal of the research is to find out: (1) why the nonprofit medical organizations have enjoyed popularity worldwide; (2) why did for profit medical organizations prevail in the Georgian healthcare system, instead of nonprofit ones; and (3) whether the current Georgian legislation is favorable for the development of nonprofit hospitals in Georgia.

Methodology

The qualitative study was conducted by using face to face interviewing method. Questionnaire was flexible and non-structured. Six in-depth interviews were conducted with managers of nonprofit medical organizations currently operating in Georgia. According to the Ministry of Health, there are only three nonprofit medical organizations in the country. Therefore, research covered

all three clinics: Drug Rehabilitation Center "Uranti", Jo Ann Medical Center and Georgian-French Medical Center "Kakheti-Ioni". Two managers were interviewed from each clinic.

The interviews were of verbal type and with the consent of the respondents they were recorded for the accuracy and detailing. After collecting the data, interviews were transcribed and analyzed.

All three interviews contained three different, often mutually exclusive answers making the research process more interesting and enabling us to draw comprehensive conclusions to determine the specific nature of operation of nonprofit organizations in Georgia. Interviews have been conducted in April-May, 2018 in Tbilisi, Georgia.

Results and discussion

The development of nonprofit hospitals in Western countries was encouraged by the exemption from the income and property taxes. According to the Civil Code of Georgia: "The purpose of creating and deploying a non-entrepreneurial legal entity first of all is a noncommercial activity to achieve certain goals. Such organizations are mainly created to benefit the public. Generally, the aim of the activity of a non-entrepreneurial legal entity can be any of the things that are not prohibited by and are not contrary to the applicable legislation" (paragraph 2 of Article 33 of the Civil Code of Georgia). The law provides for the main principle of a nonprofit organization that implies the profit reinvestment. Namely, the founder or group of founders does not have the right to derive the profit of the organization as dividends.

According to the Tax Code of Georgia, medical services, any activities envisaged by the state healthcare programs are Value Added Tax (VAT) exempt (Article 226 of the Tax Code of Georgia). The property of medical institutions used for medical activities and the part of the profit of medical institutions received from medical activities (regardless of organizational-legal form), which will be used for reinvestment (rehabilitation of the institution, provision of technical base) and incentives of the personnel are not

taxed (Article 97, Chapter XIII “Profit Tax”, Tax Code of Georgia).

Although a non-entrepreneurial legal entity cannot be commercially oriented, it is entitled to engage in entrepreneurial business activities. Profits derived from such activities shall be utilized to realize the goals of non-entrepreneurial (noncommercial) legal entities and the distribution to non-entrepreneurial legal entities founders, members, donors, and persons with management and representative authority is prohibited.

Before 2017, the Tax Code of Georgia provided the profit tax for organizations with entrepreneurial status at the rate of 15%. In 2015, the Government announced a significant change in the Tax Code, which meant the introduction of the Estonian model of profit tax. This change took effect under the Order No. 9 dated January 13, 2017. Estonian model implies not taxing reinvested profit together with profit tax (21%). As a result of the changes in the Georgian legislation, the reinvested profit is exempt from any profit tax. These tax benefits were enjoyed exclusively by nonprofit organizations until 2017. After the legislative amendments, the entrepreneurial legal entities were also given the right to enjoy these benefits.

Therefore, in accordance with the Georgian legislation nonprofit organizations in respect of the tax benefits are the same as profit organizations.

In order to study the problems of nonprofit medical organizations in Georgia, we conducted an in-depth interview with managers and experts of nonprofit medical organizations. Due to the small number of nonprofit medical organizations operating in the country, the research area was limited and covered only three clinics: Drug Rehabilitation Center “Uranti”, Jo Ann Medical Center and Georgian-French Medical Center “Kakheti-Ioni”.

The drug rehabilitation center “Uranti” was founded in 2013 as a nongovernmental organization. It is governed by the Board that is headed by the Chair. The Board consists of general director, clinical and financial directors, as well as the quality control manager and other administrative staff. The Board decisions are controlled

by the Supervisory Board, which also manages the distribution of financial resources. The clinic does not have a single manager, but the Chief Administrator is the Chair of the Board. The Chair of the Board alternates periodically.

As interviews have demonstrated, compared to other forms of ownership, the nonprofit medical organization does not pay value added tax and the medical personnel receive higher salaries. Seventy percent of the expenses are the salaries of the medical staff, 15% are administrative expenses, about 10% is utilities cost, and the remaining 5% are retained as the profit, which is spent on infrastructure development, repairs, and equipment upgrading, medical personnel training. In the event of reinvestment of profits, the drug rehabilitation center pays profit tax at the end of the year like every institution operating in Georgia,

The main source of financing of the Drug Addiction Rehabilitation Center is the state programs. The center has inpatient and outpatient departments. Approximately 18,000 patients visit the outpatient department and about 200 patients refer to the inpatient department yearly. High incidence of outpatient visits is caused by the fact that the center has its constant contingent, which periodically visits it. The lower load of the inpatient clinic is associated with its small size.

State’s negative attitude towards nonprofit organizations and artificial obstacle creation was named as one of the main difficulties for the functioning of the center. One of the managers says:

“Government’s negative attitude towards nonprofit organizations, is the main hindering factor for development of such organizations in Georgia. Unlike state medical institutions, the administrative expenses of the Center are low and the Center seeks to increase the salaries of medical personnel. This, in turn, makes the state sector non-competitive but instead of raising the quality of services of state medical organizations, the state tries to create unfavorable conditions for the nonprofit medical organization. Thus, the state prevents healthy competition between medical organizations”.

The example of a heavy-handed interference of the state in the functioning of the Center is the termination of the state program of methadone

maintenance treatment. However, despite the fact that most of the patients prefer treatment within the Free State program, the Center has its own contingent. According to the expert:

“The development of nonprofit medical organizations in Georgia is prevented due to the rigid legislative system. Therefore, we should assume that the state is not interested in the development of nonprofit organizations”.

In the manager’s opinion, “due to political, legislative, social and cultural factors, there are no favorable conditions for the development of nonprofit medical organizations in Georgia; moreover, its functioning is associated with great risk”.

Because of the above-mentioned factors, in Center’s management’s opinion, it will be better to reorganize the nonprofit organization into a limited liability company. According to the respondent, the fundamental system and legislative amendments are necessary for the development of nonprofit medical organizations in Georgia.

The Jo Ann Medical Center has the longest history of operating as a nonprofit medical organization in Georgia. And this history is a successful one. The center was founded on September 16, 1996 with the support of the famous American actress Jo Ann McGowan. In Georgia there was no viable cardiac surgery center for children at that time. As the result of the meeting between the Georgian cardiac surgeon Irakli Metreveli and Jo Ann, an idea of establishing nonprofit medical center, with the profile of cardiology and cardiovascular surgery has emerged. US charity organizations, including the organization “Global Healing”, have made valuable contributions for creation of this center, as well as for enhancement of qualification of appropriate medical staff. On September 23, 1996, Jo Ann McGowan died of a stroke just in one week after the Center named after her was opened in Georgia. The Center that she founded still functions today in Georgia.

The Center has five founders, including Georgian and US citizens. They are still participating in the management of the Center. The group makes the core strategic decisions. The

Board of Founders appoints the General Director of the Center who is responsible for the management of the Center. The Board does not interfere in the daily activities of the center, unless the cases require important decisions, such as purchase of new medical equipment, opening an additional department and etc.

Donor organizations and healthcare programs such as: The State Universal Healthcare Program and State Program of Referral Services are the sources for center’s funding. By the State Program of Referral Services, the state finances 100% of children’s congenital heart diseases and other pathologies. In addition, State Universal Healthcare Program funds health care services for adults. The share of the State Universal Healthcare Program in the total revenues of the organization makes up 80%. The remaining 20% accounts for the direct payments of the patients and the amount paid by the insurance companies.

At present, all the manipulations and operations of the cardiologic profile of children and adults are conducted in the clinic, except for heart transplantation. The profit received in the Center is fully reinvested in the development of the medical organization. Three of the founders are employed at the same clinic at different positions, and therefore they receive remuneration only in the form of salaries. The profit is distributed for the purchase of new medical equipment, enhancement of the staff qualification, increasing salaries, raising the quality of medical services. About 55% of total income is spent on the payroll for medical and administrative staff. However, at the expense of the introduction of automated control systems, the management seeks to reduce administrative resources.

The salary of the staff employed in the Center is usually taxed by the state at 20%. The salaries of medical staff of the Center exceed the salaries of the staff of medical organization of the same profile. The medical center does not try to increase profit by the artificial reduction of human resources. One patient in the intensive care unit of the Center is supervised by one nurse for 24 hours, while in other medical organizations one nurse shall supervise 3-4 and sometimes more patients. The applicable Tax Code does not

provide tax benefits for a nonprofit medical organization.

The Center tries to contribute to the enhancement of staff qualification and improvement of the environment for their activities. The Center finances participation of its personnel in the medical conferences, trainings and continuous medical education. For example, in the course of research, the medical center funded doctor's participation in the international conference in Germany, which was dedicated to diagnosis and treatment of congenital heart diseases.

Along with improving the level of professionalism for its medical staff, the Jo Ann Medical Center, seeks to up bring new generations and support them in getting adequate education. The Center plans to introduce a residency in child cardiovascular surgery and child rheumatology, thus contributing to the development of new qualified staff.

The center spends a lot of money for purchasing the advanced equipment. The Center plans to set up new profile medical departments with cutting edge technology.

The lack of state support, was named as center's main problem. In the expert's opinion:

“According to the Tax Code the Center does not pay profit and property taxes. However, funding of the diseases defined by state programs is carried out by tariffs established several years ago and does not take into account the significant change in the US dollar rate of exchange. At the same time, the Center purchases the necessary materials (artificial and biological cardiac valves, etc.) in US dollars, while the existing rates remain the same and have not been reviewed. As a result, the expenses of the center have increased that has negatively reflected on its financial position and development in general”.

Despite the problems, the Jo Ann Medical Center is considered one of the successful clinics in the South Caucasus, which enjoys great authority and trust in the population.

The French-Georgian Medical Center “Kakheti-Ioni” was founded in 2006 with the support of France. It is a multiprofile clinic. In 2016, the Center involved in the Hepatitis C elimination program for which the relevant diagnostic and medical departments were opened. Residents in Kakheti region can undergo

screening on Hepatitis C and in case of diagnosed disease, they can be treated in the place. The Center consists of the following departments: general surgery, laboratory, diagnostic department, ophthalmology, otorhinolaryngology, gynecology, oncology, hematology etc.

The founder of the Center is the French Senator Anri de Renkur. It is managed by the Board composed of Georgian and French representatives. The Board is responsible for making important decisions for the clinic. The Center plans to develop telemedicine and acquire new diagnostic equipment.

Conclusion and recommendations

The medical market requires the existence of many forms of ownership of medical organizations featuring private nonprofit, private profit, state and state-private partner organizations.

There are only few nonprofit (noncommercial) medical organizations on the Georgian medical market. It seems that there is no sufficient motivation for the functioning of nonprofit medical organizations.

Although the Tax Code provides tax benefits, they exist only in a token way and does not support the development of nonprofit medical organizations in Georgia. It is noteworthy that, as a result of the legislative amendments made in 2017, nonprofit organizations do not differ from profit organizations in respect of tax exemptions.

It is necessary to improve the tax benefits provided for nonprofit hospitals in the Tax Code and share the world experience. It is recommended for Government to give more support to nonprofit organizations, in order to increase their functioning efficiency and bring incentive for development of new nonprofit medical institutions.

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