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Long term care financing in four OECD countries: Fiscal burden and distributive effects

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Abstract

This paper compares long term care (LTC) systems in four OECD countries (UK, Japan, Sweden and Germany). In the UK, provision is means tested, so that out of pocket payments depend on levels of income, savings and assets. In Sweden, where the system is wholly tax-financed, provision is essentially free at the point of use. In Germany and Japan, provision is financed from recently introduced compulsory insurance schemes, although the details of how each scheme operates and the distributive consequences differ somewhat. The paper analyses the effects of importing the other three countries' systems for financing LTC into the UK, focussing on both the distributive consequences and the tax burden. It finds that the German system would not be an improvement on the current UK system, because it uses a regressive method of financing. Therefore, the discussion of possible alternatives to the present UK system could be restricted to a general tax-based system as used in Sweden or the compulsory insurance system as used in Japan. The results suggest that all three systems would imply increased taxes in the UK.

JEL classification: H51; I18; J11

Keywords: Long term care; International comparisons; Tax burden; Distributive effects

1. Introduction

As with public pension schemes, public systems for long term care (LTC) redistribute resources between generations, genders and people in different income groups. Accordingly, the implications of different models of financial provision need to be analysed in terms of sustainability and social justice. Do different systems fare differently as the ageing process takes off in the near future? Who are the typical gainers and losers from different systems? It is the purpose of this paper to analyse these and related issues, using a disability projection model developed by Rickayzen and Walsh [1].

There is a considerable variety in the systems developed in different developed countries to provide long term care (LTC) for the elderly. In all developed countries, citizens in need of care, who cannot afford long term care by other means, are given publicly financed care. On top of this minimum state intervention, there is a wide range in how much a state is involved in the

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financing and provision of long term care. The Scandinavian countries have developed models where local authorities provide services virtually free of charge, whereas the U.K. and the U.S. tend to give the state the residual role to finance LTC once other potential sources have been exhausted. Most other countries are somewhere between those two extremes (cf. [2]).

These differences in the role of the state have implications for the aggregate costs. In Sweden, total public expenditure on LTC for elderly comes to 3.2% of GDP [3]. This is more than three times as much as in the U.S., where total public expenditure is less than 1% of GDP (cf. [4]). Most countries lie somewhere in between. For instance, in the U.K. around 1% of GDP is contributed from the public purse each year [5]. The cost to the state is a function of the proportion of the population who are elderly people requiring LTC, as well as the actual cost of care.

It is unclear, though, to what extent those differences are due to different degrees of state intervention, since the national systems differ in many other ways as well. Each country has its own definition of LTC, and each country offers its particular package of services. Furthermore, relative prices of LTC tend to be different in different countries. On top of that, assessment of need and eligibility criteria-both financial and in terms of disability-differ, as well as the duties assigned by law to spouses and children.

These differences in the design of the systems clearly have important implications. The aggregate costs of publicly financed LTC, which vary between the countries right from the outset, will probably evolve in different ways as demographic changes occur. Furthermore, a public LTC system implies that there is redistribution of resources going on (the most important one being between healthy and disabled people, but also in other dimensions). Given the considerable differences between the various LTC systems, one would expect the distributive effects of the systems also to differ quite substantially.

The purpose of this paper is to deal with those two issues, i.e. cost implications and distributive effects. We want to make comparative forecasts on how total public spending would evolve if different models of LTC provision were tried out in the same country. Furthermore, we would like to determine who are typically the main ‘gainers’ and ‘losers’ from the different systems. This is done by calculating the net present value (NPV) and ’money’s worth’ of the public LTC system in different countries. The former measure tends to be more interesting from a societal point of view: accounting for the amount of redistribution taking place in the system, whereas the latter is of more interest from the individual perspective.

Our study covers the LTC systems in four different countries: Japan, Germany, Sweden and the U.K. There are three main reasons for selecting these countries. Firstly, it is evident that they are all taking the costs of provision and the means of financing very seriously, since they have each undertaken a range of reforms in recent years. Ageing is proceeding rapidly in each country and the numbers of elderly are predicted to grow substantially. On the other hand, the policy responses have been very different, as well as starting from different bases and social traditions.

This paper is a contribution to an emerging literature on comparative advantages of different systems for financing LTC. Wittenberg et al. [6] provide a good theoretical overview of the policy options and the tradeoffs connected with designing a system for LTC financing and provision. Comas-Herrera et al. [7] analyse the impact of population ageing on public spending in four European countries. In addition, they analyse the implications of introducing a more comprehensive LTC system in countries where the support system has traditionally been relying on informal care and private funding. The main difference between that study and ours is that we analyse the economic implications of different systems on public spending and equity, when applied to the same country-the United Kingdom. Furthermore, our disability projection model is a multiple state model whereas the models used by Comas-Herrera et al. [7] are cell-based macrosimulation models.

Here, we present an alternative to existing methodologies for analysing the long term effects of policy reform on the LTC sector. The main advantage of our approach is that the disability projection model is based on individual transition rates from one level of disability (including “no disability”) to another. Hence, individual trajectories of disability can be followed over the entire life cycle. Using this approach, we can make a complete estimate of the contributions paid to, and the benefits received from, the public support system for different types of individuals. This information can be used to compare the net balance of different