Response to the Productivity Commission's Caring for Older Australians Draft Report

This submission focuses on the issues of financing addressed in Chapters 6 and 7 of the Draft Report.

The submission is in three parts. Following the structure of the Draft Report, the submission addresses the issue of *Intergenerational equity*, the *funding of accommodation services*, and the *funding of personal care services*. In each case the submission argues that a broader approach to the policy settings of aged policy are necessary to avoid reinforcing existing inefficiencies and inequalities and instead addressing serious problems in the structure of existing policy. Of most significance is acknowledging the large tax concessions promoting saving for older age through owner occupied housing and superannuation.

It concludes that a more uniform approach that seeks to extend the principles of universal provision found in the provision of health care services to all accommodation and personal care services, is both more efficient and more equitable than alternatives proposed in the Draft Report. This could be financed with minimal, if any, new or increased taxes through the restructuring of existing tax supports.

Intergenerational Equity

The Draft Report identifies 'intergenerational equity' as a primary equity consideration in identifying the source of increased funding required by the sector. In particular it notes that many older Australians "have sizeable assets" (p.139), that might be used as a source of private funding.

The current analysis is limited to focusing exclusively on aged care, and takes the broader policy context as given. As such, it does not acknowledge that the disproportionate accumulation of wealth by older Australians is actually the result of other government policies that systematically encourage savings during a person's working life to enable a reasonable standard of living in older life. Indeed, without owner-occupied housing, many older Australians are at serious risk of poverty.

For the majority of older Australians, the capital assets they have – their own home and modest superannuation – are essentially capitalized income (substituting for imputed rents and annuities). Were public policies altered to incorporate superannuation into the public pension (allowing differential public pensions that reflected past earnings) and to extend public housing, most older Australians would have minimal capital assets while enjoying similar or identical standards of living. This is despite older Australians having on average lower standards of living than the younger population.

As the capital assets of older Australians are at least partly a reflection of other government policies, it is sensible to examine the interaction of existing

policies and new policy recommendations. On this basis, the current proposal to extend user payments appears highly regressive.

Current policies encourage saving through concessions on taxation. The main support, the concessional treatment of superannuation deposits, interest and withdrawals, and of owner occupied housing on imputed rents and capital gains, are substantial. The superannuation concessions amount to almost $30 billion per annum, while tax concessions on owner occupied housing are estimated at around $40 billion per annum (Treasury 2011). Each is substantially larger than the entire aged care budget.

These tax concessions effectively reverse the normal tax scale by reducing tax liabilities. As a result, the distributional effects are grossly inequitable, and often highly regressive (see Spies-Butcher & Stebbing 2009). Thus, the combined effect of current and proposed policy would be to subsidise saving for older age by disproportionately assisting those on the highest incomes, and then funding aged care by imposing costs on that accrued savings at a relatively flat rate, and thus imposing the largest proportionate imposts for those on low-incomes with low savings. This remains the case even if a means test allows some access without payment. This interaction effect reveals a substantial inequity.

Secondly, while inequalities in wealth between generations are substantial, they are also a desired outcome of government policy that reflects the life cycle. A more worrying inequality is that between genders. Again, the proposal exaggerates existing inequalities in this respect. The tax concessions on savings, particularly those for superannuation, disproportionately benefit men, reflecting differential labour market participation and rewards (see Sharp & Austen 2007; Jefferson 2009). For those most likely to need care, those aged over 85, this includes many women who also experienced considerable formal discrimination through lower wages. Yet, as the Draft Report acknowledges (p.148), women face much higher risks of entering aged care and being exposed to substantial user payments. Thus, the interaction of existing and proposed changes exaggerates the existing gender inequalities of current government policy for the aged.

Higher individual incomes generally reflect labour market participation, and those on higher incomes have a higher propensity and capacity to save. Thus, policies that promote savings reinforce existing income inequalities. Concessions for savings also distort investment markets by favouring some forms of saving over others, something potentially reinforced by creating means tests to exempt low-income earners, as acknowledged in the Henry Review.

Rather than maintaining these policies and introducing new charges to access this savings as a source of funding for aged care, it would be more direct,

transparent, equitable and efficient to redirect a small part of this existing support into the services used by older Australians. This would ensure the funding maintained similar social policy objectives (securing people from the risks of low income and higher care costs in older age) while substantially minimizing current inefficiencies and inequalities. This would also address inefficiencies that result from user charges, which I address below.

Accommodation Services

The Draft Report makes two claims in relation to accommodation costs that underpin the conclusion that these costs should be born individually. This submission suggests that neither claim is sound. Taking a broader view of policy settings, it is clear there is already considerable fiscal support for most Australians to meet accommodation costs, while the nature of the housing market means there are substantial transaction costs that make it difficult to assume capital mobility.

The first assumption is that older people are generally "expected to meet these [housing] costs themselves and, as such, grounds for government subsidising these costs are weak, except for those of limited means" (p.144). This is clearly incorrect as an assessment of current policy. Owner occupied housing currently receives tax concessions equivalent to $40 billion per annum, substantially higher than the total cost of the aged pension. This support is broadly directed at large sections of the population, including those with considerable means. As the Tax expenditure statements, the NSW Independent Pricing and Regulatory Tribunal (IPART) and the Henry Tax Review suggest, it is inappropriate to ignore these expenditures on the basis that they lack transparency.

Second, the Draft Report suggests that accommodation costs "are reasonably predictable expenses of everyday life" (p.144). The need for accommodation is predictable, but its costs are not, unless we assume near perfect mobility of capital. If older people are not expected to rent, mortgage or sell one form of accommodation when entering another, then costs are highly unpredictable, in that some older people will require no additional accommodation, while others will require an extended stay in alternative accommodation.

The implicit assumption of the Draft Report is that older people can rent, mortgage or sell existing accommodation when they enter residential or aged care facilities. This is an unreasonable, and potentially inefficient, assumption. Such capital mobility presumes a high level of financial literacy. It also discounts the costs associated with uncertainty and attachment to a particular home. Behavioural economics shows that people are often risk adverse, while there is clear emotional attachment to the family home, fostered by government policy, that must be assumed to be associated with some welfare benefit.

The stress that clearly is experienced by many older people in selling their own home at a time when they are also subject to significant frailty must be

accounted as a form of disutility that results directly from the proposed policy. In addition, any government oversight and administration of new financial regulation aimed at assisting and protecting older Australians as they attempt to access the capital in their home should be costed and treated as a transaction cost of the proposed policy. Finally, many older people will spend only a short period in care, such that these transactions are incurred for what are minimal costs. A key difficultly is in predicting the cost of accommodation associated with care at the individual level. Given this, it is likely the current proposal is far from welfare maximizing.

If capital is not perfectly mobile, then it is incorrect to assume that accommodation costs "are reasonably predictable expenses of everyday life". If instead, housing capital (at least the family home) is presumed to be partly immobile, associated with welfare losses due to emotional attachments, transaction costs and imperfect rationality, then accommodation costs are highly unpredictable and better addressed through universal pooling arrangements.

To the extent that the proposal is an attempt to more equitably distribute the costs of aged care amongst those with housing wealth, it amounts to a less equitable form of death duties or inheritance taxes. Indeed, the Report seems to suggest similar goals to a death duty, but seeks to impose this cost at a time that is likely more stressful and in a manner that is considerably less equitable. If the Commission's goal is to more equitably distribute costs based on wealth, a formal inheritance tax would achieve this goal more successfully. Such a tax is widely acknowledged by economists to have relatively low costs due to reduced incentive effects.

It is clear that current government policy does subsidise accommodation costs, indeed this is one of the most heavily subisidsed areas of social provision. The Draft Report's conclusions are based largely on an unjustified distinction between direct payments and tax concessions, a distinction rejected in both the Treasury's *Tax Expenditure Statements* and the Henry *Tax Review*. Given the substantial additional (monetary and non-monetary) costs association with forcing older Australians to access housing capital when entering care, it is also unlikely that the proposal is welfare enhancing. Finally, current funding arrangements create a dubious distinction between health care and residential care. To remove this uncertainty it would be far more logical to extend the principle of universal provision and risk pooling by providing publically funded aged care facilities available to all and free at point of entry.

Personal Care Services

The Draft Report already acknowledges the unpredictability of personal care costs at the individual level, and thus endorses the principle of universal provision of catastrophic personal care costs. However, it argues that there remains a case for user

payments. The case justifying this approach seems particularly difficult to follow. Again, when the broader context of government policy is examined, user payments appear to reinforce inefficiencies and inequalities rather than providing a sensible policy direction.

The Draft Report suggests that as some care costs in the health care system already attract user payments ("There are co-contributions subject to means-testing and a capped safety net for primary care services and pharmaceuticals" (p.151)), the principle could be extended. This institutional bias seems a poor rationale for future reform proposals. Especially as health care financing has proven one of the most contested policy domains since the Second World War, and there is considerable expert opinion that the reforms mentioned, particularly in primary care, have promoted inequities and inflationary pressures.

Second the Draft Report claims that without user payments government expenditure would increase, and that this "can reduce efficiency" (p.152). It is difficult to interpret this statement, but it is likely to refer to the potential 'deadweight' costs of taxation (box 6.2). Instead, the Draft Report argues that individuals should 'self-insure' for these user payments. The main form of self-insurance is superannuation, which is already heavily subsidized. Thus, the proposed policy essentially relies on large tax expenditures that impose an even larger fiscal burden in order to avoid the smaller fiscal burden of eliminating user payments.

The Draft Report also suggests co-contributions generate desirable dynamics by reducing demand for services, and promoting better quality services. This is only true to the extent that consumers are well informed and able to properly exercise consumer sovereignty. There are numerous barriers to this, including poor access to services in some locations, and an asymmetry of information between providers and recipients. Any dynamic based on payment designed to improve service quality is also likely to be confined to the user-pays section of the market, and thus likely to entrench a 'two-tiered' service system.

Even if this were not ethically objectionable, it is likely to generate inefficiencies. The aged care sector, like the health sector, requires different elements of the system (those providing free and priced alternatives) to compete for the same pool of resources, especially appropriately skilled labour. Evidence from the health care sector suggests that providing higher monetary rewards in one element of the system increases costs in the other by bidding up the cost of labour. User payments also reduce the monopsony effect enjoyed by government, and this tends to increase prices. Thus, this policy is likely to result in higher unit costs, and undermine overall efficiency in the sector.

Moreover, personal care is only subsidized if it is professionally recommended. Such care is preventative, and is acknowledged elsewhere in the Draft Report as the basis of considerable savings (section 6.1). Thus, reducing demand via price signals is at least as likely to increase costs by failing to provide

preventative care as it is to reduce costs. Again, evidence from the health care sector suggests that the services that are reduced by price signals are not the services that are least ‘needed’ or have the smallest marginal benefit.

Finally, the Draft Report acknowledges that means-testing would still be required and that this generates inefficiencies due to interactions with other government policies, creating perverse incentives. Thus, universalizing the safety net (ie eliminating user payments) will have some efficiency benefits.

The main reasons for advocating user payments for personal care services appear weak. Additional fiscal resources are available from reform to the tax support for savings that if anything are likely to improve overall economic efficiency, rather than impose deadweight loses. The introduction of user payments actually relies, implicitly, on these inefficient and inequitable tax concessions because this is the most likely way for people to ‘self-insure’.

Like health care services, personal care services are effectively prescribed, limiting consumer sovereignty, and are acknowledged to prevent future ill health and fiscal costs, and so have substantial public goods qualities. Evidence from health care suggests user payments can reduce demand, but tend to do so in ways that are inefficient. User payments can also increase unit costs by reducing government power to restrain costs, and creating competition for skilled labour between those paying additional costs and publicly provided services to those subject to a means test.

Finally, providing different funding rationales for personal and health care, and retaining free access to some citizens, creates perverse incentives. These distortions are difficult to justify when less distorting alternatives are available through more direct public provision.

Conclusion

The Draft Report recommends the substantial extension of user payments. However, its rationale ignores many of the benefits of universal provision, and the interaction of explicit aged care policy and other government support for ageing. As a result, the proposals for extending user payments to personal care and accommodation are likely to both exaggerate existing inequities and undermine efficiency.

Finally, it is useful to note that the Government is proposing to increase the rate of compulsory superannuation contributions. This is despite a contrary recommendation from the Henry Review, and recent evidence suggesting the superannuation remains a poor savings vehicle for many workers. This potentially opens an opportunity for the Commission to recommend that part of this increase be directed to fund aged care (at least for those aged over 40 along the lines of recent Japanese reforms). Given the existing Government

commitment, this is likely to increase efficiency, and would serve the same policy purpose – preparing Australia for the costs of an ageing society.

References

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