Long Term Financing Options for Aged Care in Australia

Lessons from the Royal Commission

Dr David Cullen, BA BSc PhD FRSPH; NATSEM

Bridget Browne, BEc FIAA; EY and ANU

Disclaimer / Acknowledgement

- The views expressed in this presentation are not necessarily those of:
  - EY
  - the National Disability Insurance Agency
  - the Australian Government
  - the Royal Commissioners into Aged Care Quality and Safety

- We acknowledge the Ngunnawal people, who are the traditional owners of the land from which we are giving this presentation.

Outline

- Dialectic
  - Neglect
  - Why is it so?
  - What is to be done?
- Praxis
  - A hypothecated aged care levy

Neglect

- Too many older people are not getting the aged care they need at the time and level they need it.
  - Home Care Package Waiting List Those with the highest levels of need wait up to 36 months
- Care level are insufficient
  - People receiving the highest level of care at home get slightly more than one hour of care a day.
  - Half of aged care homes have inadequate staffing to meet need
- Quality is not at the level that Australians expect. The Commission found that:
  - Between 22%–50% of people in residential aged care were malnourished
  - Between 75%–81% of people in residential aged care were incontinent
  - Pressure injuries occur in a third of the most frail residents towards the end of their lives
  - About 61% of people in residential aged care were regularly taking psychotropic agents

Outline

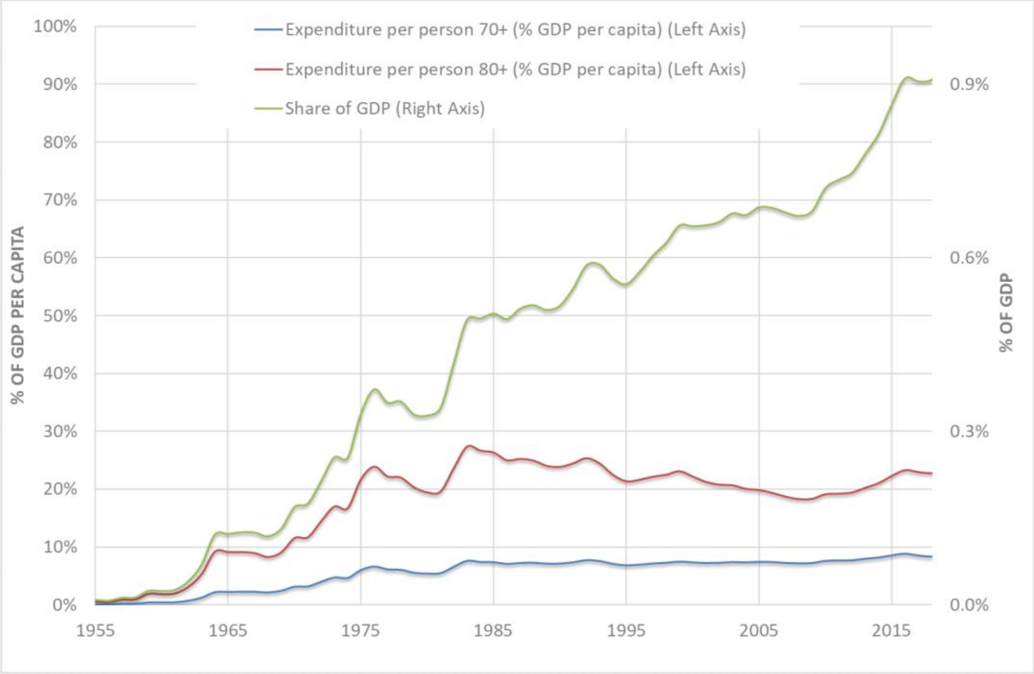
- Dialectic
  - Neglect
  - **Why is it so?**
  - What is to be done?
- Praxis
  - A hypothecated aged care levy

Why is it so?

- The history of aged care policy is a history of decisions about how much taxpayers are willing to spend on older people.
  - 1900-50s – Age Pension was sole support for older people (minimal welfare)
    - John Forest - "No one is to receive an old-age pension unless he (sic) is unable to maintain himself."
  - 1950s-65 – Increasing accommodation costs led to a capital program for nursing homes
    - The alternative was an increase in the age pension or demand for hospital care
  - 1965-85 – Recurrent subsidies for nursing homes
    - The alternative was higher hospital costs or an increase in the age pension)
  - 1985 – Demographic switch point when 85+ population issues began to dominate the 64+ issues
  - 1985-2005 – Expanding community care to leverage informal care
  - 2005-now – Expanding support for informal carers to sustain the expansion of community care
    - "free" informal care had to be incentivised in a growing economy

Why is it so?

- Australian government expenditure on aged care has not kept pace with demand since at least 1984-85 because of two main factors:
  - The growth in number of aged care places was linked to the 70+ population, whereas demand for aged care was more closely correlated to the 80+ population; and
  - An annual efficiency dividend has been imposed on aged care providers since 1996-97 through the Commonwealth Own Purpose Outlays/Expense arrangements.



Why is it so?

- When the 1997 Aged Care Reforms were considered by Government, the Cabinet was told by the Department of Health that "Government has total control over all of its parameters", including:
  - "applying quotas to numbers of people at various care levels"
  - "an efficiency dividend or other adjustment to funding structures"
  - "changes to service provision benchmarks"
- The Commission found that aged care funding in 2018-19 was 53.9% ($9.8 billion) lower than it would have been without these policies.
- It also found that much of the bad quality it had observed could not be divorced from this parsimony.
  - "The current aged care system and its weak and ineffective regulatory arrangements did not arise by accident. The move to ritualistic regulation was a natural consequence of the Government's desire to restrain expenditure in aged care. In essence, having not provided enough funding for good quality care the regulatory arrangements could only pay lip service to the requirement that the care that was provided be of high quality."

Outline

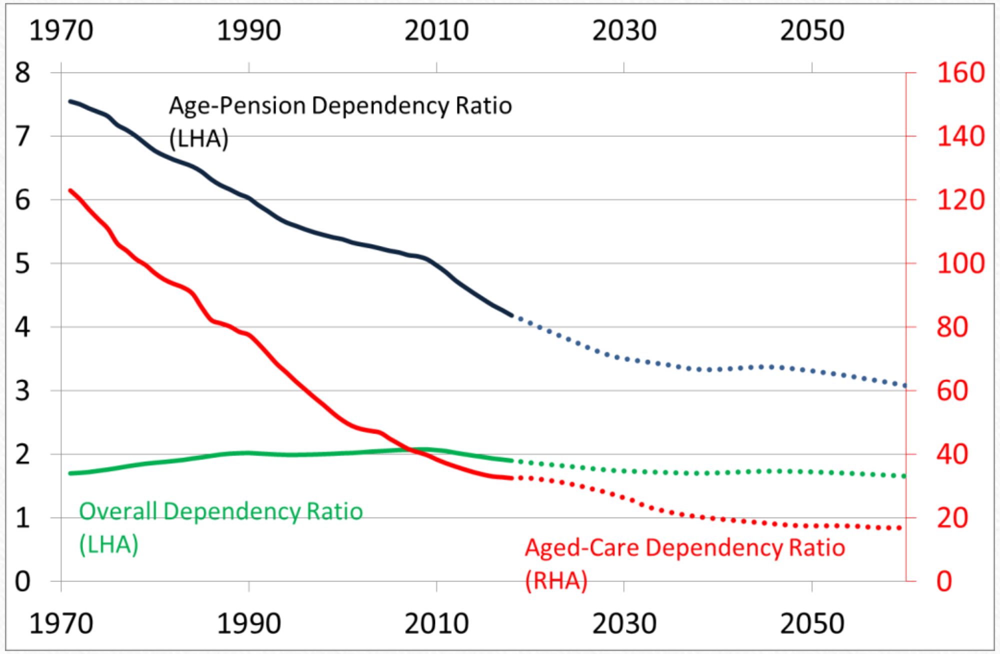
- Dialectic
  - Neglect
  - Why is it so?
  - **What is to be done?**
- Praxis
  - A hypothecated aged care levy

What is to be done?

- It is not surprising that Governments are concerned about the costs of older people.
  - In 2017-18, older people accounted for 21.4% of all Australian Government expenditure
    - $45.4 billion on income support; $31.0 billion on health care, $21.4 billion on aged care
  - Tax expenditure on older people is also significant
    - $34.3 billion on superannuation; $3.0 billion on health care

What is to be done?

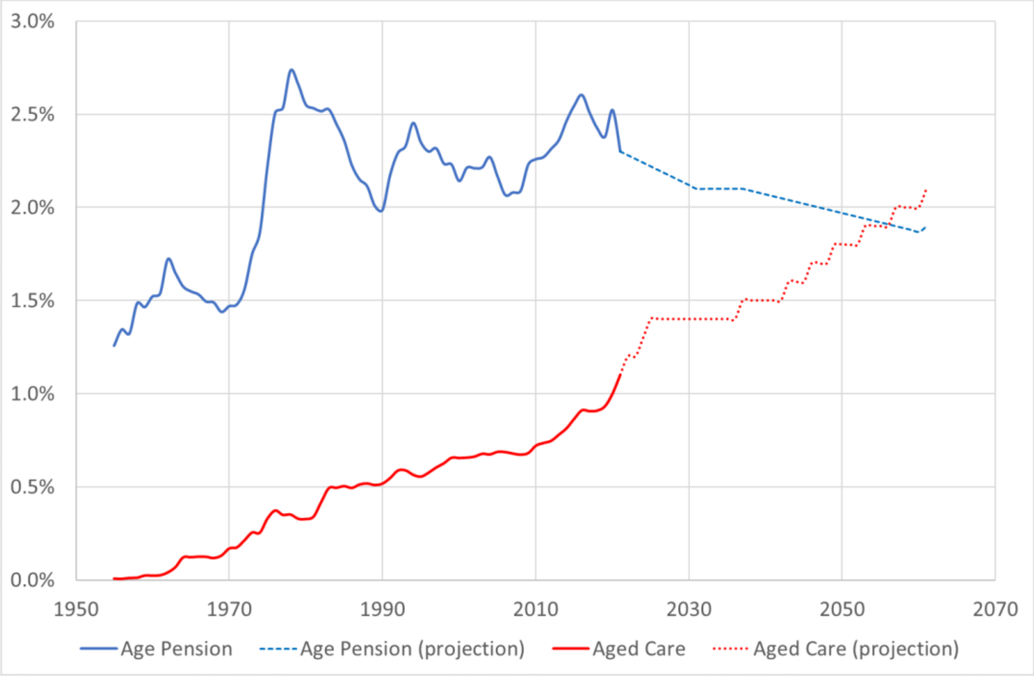
- The key issue is how to overcome the tyranny of the mismatch in the growth of generations?



What is to be done?

What is to be done?

- Successive governments have largely tamed the problem of retirement incomes
- Since the mid 80s the real growth pressure has been the 85+ population (aged care) not the 65+ population (age pension)
- By 2055, expenditure on aged care will be greater than expenditure on the age pension



Building Blocks of a Future System

- **Independent Financing**
  - **Governments face budget choices**
  - Aged care expenditure, unlike expenditure on much other health care, education and some welfare services like employment services, does not have an investment effect
  - **Therefore best conceptualised as social insurance (income smoothing)**
- **Other financing**
  - Private insurance (in theory) but need to avoid moral hazard to the social insurance arrangements
  - Means testing does not align with social insurance (but could form a bridge between generations while social insurance builds)
- **Independent Governance**
  - Must control its own revenue
- **Independent Quality Assessment**
  - When the funder determines what is good quality then compromises occur
- **Ombudsman**
- **Subsidiarity**
  - Local solutions for local issues

Financing Design Principles

- Predictable
  - Ensure that people's expectations for high quality aged care are met as assessed and when they are needed.
  - People should not be subject to unpredictable costs in the future.
- Reliable
  - Ensure that the funds necessary for timely and equitable access to high quality aged care are available as assessed and when they are needed.
  - Funding should not be subject to the annual budget cycle and fiscal priorities of the government of the day.
- Equitable
  - Financing arrangements should maintain the general progressivity in the current taxation system.
  - Access to care should be on the basis of need
- Objective
  - The amount of funding necessary to provide expected benefits to meet assessed needs should be arrived at using the best available evidence, knowledge and expertise.
  - Independent assessment of need
- Economically sound
  - The arrangements should ensure that there will be sufficient funds raised to meet expected expenditure.
  - As far as possible entrepreneurship should be encouraged, with constraints of quality and safeguards
- Accountable and transparent
  - Arrangements should be publicly visible and accountable so that taxpayers can see the connection between their payments and the effective operation of the aged care system.

Outline

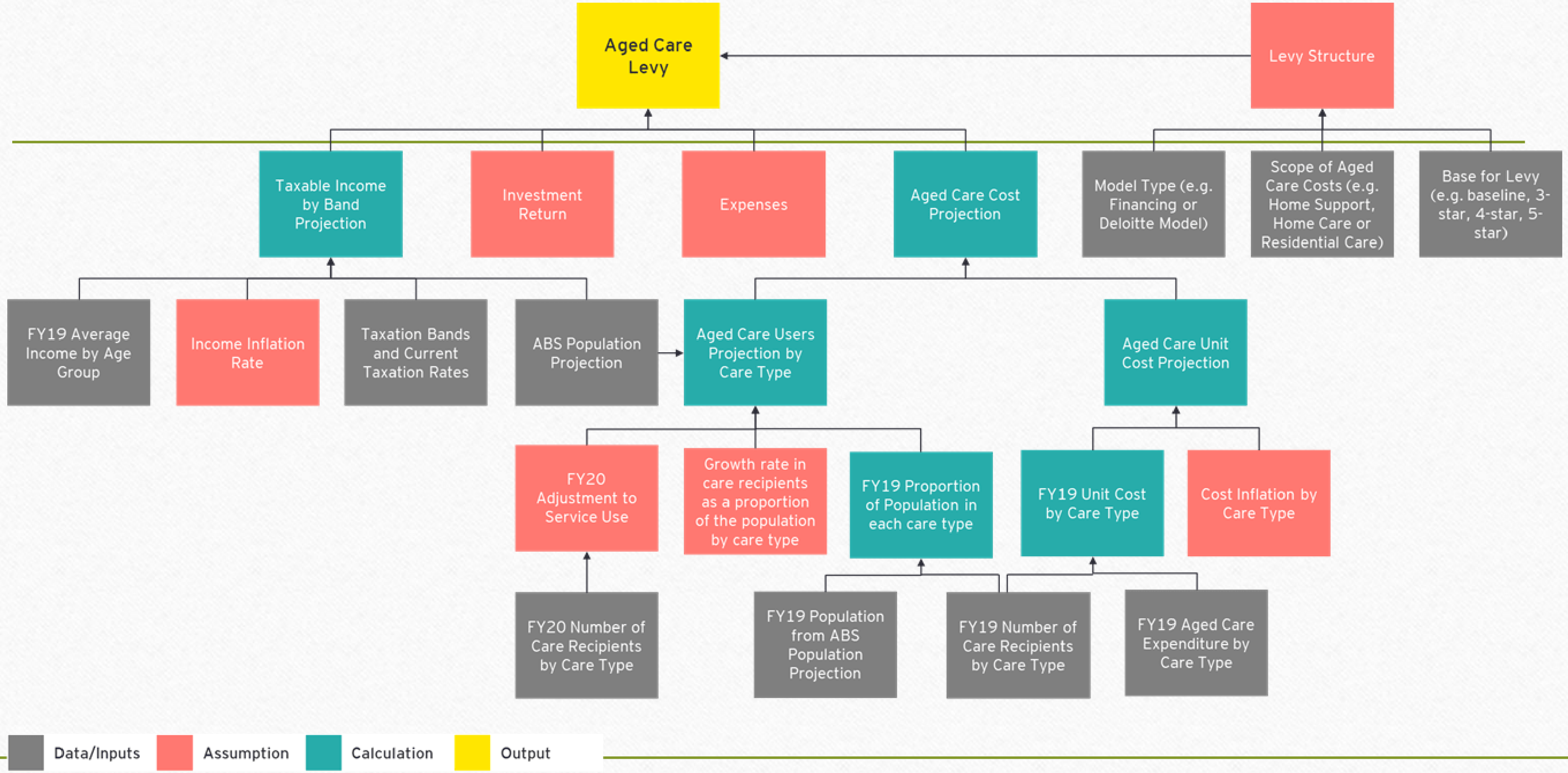
- Dialectic
  - Neglect
  - Why is it so?
  - What is to be done?
- Praxis
  - **A hypothecated aged care levy**

Modelling a hypothecated aged care levy

- Long run ‘pay-as-you-go’
- Possible revenue bases
- Monitoring process
- Degree of ‘progressivity’

- Model methodology
- Scope of aged care expenditures
- Results

Model methodology



Scope of aged care expenditures

Care Type and Scope of Services	Public Costs	Private Costs
Home Support	Government Contributions	Consumer Contributions
Home Care Low	Government Contributions	Consumer Contributions
Home Care High	Government Contributions	Consumer Contributions
Residential Care (Care Only Costs)	• Basic Care Subsidies (Permanent and Respite); • Hardship Supplement; • Viability Supplement; • Grandparenting Supplements (Transitional, Charge Exempt, Basic Daily Fee); • Other Supplements (Veterans' and Homeless); and • Other Reductions	• Means Tested Care Fees; • Resident Other Care Fees
Residential Care (Living Costs)	Not Applicable	• Resident Basic Daily Fee; • Extra Service Fees; and • Additional Service Fees
Residential Care (Accommodation)	• Accommodation supplement; • Hardship accommodation supplement; • Transitional accommodation supplement; • Concessional accommodation supplement; • Accommodation charge top-up; and • Pensioner supplement	Accommodation Payments from Residents in the form of Daily Accommodation Payments (DAPs) were included as private accommodation costs. There is an option to include an equivalent RAD payment through converting the respective RAD into an annual income using an imputed interest rate.

Scenarios modelled

Aged Care Levy Variant	Description
Baseline - Current Aged Care Policy	• **Scenario 1A:** A flat rate levy on personal income sufficient to raise revenue equal to what Commonwealth Government expenditure on aged care would be under current policy settings. • **Scenario 1B:** A progressive levy on taxable income sufficient to raise revenue equal to what Commonwealth Government expenditure on aged care would be under current policy settings. • **Scenario 1C:** An alternative consideration is if individuals only have a higher additional marginal tax rate after a certain age (40 in this example) to cover the costs of aged care. As such, the levy would only apply to individuals over 40 and those under 40 would effectively have a 0% levy.
Royal Commission recommendations	• **Scenario 2A:** A flat rate levy on personal income sufficient to raise revenue equal to what Commonwealth Government expenditure on aged care would be following the adoption of the recommendations made by the Royal Commission (including the assumption that care is not means tested but that Commonwealth assistance for accommodation costs in residential aged care is means tested). • **Scenario 2B:** A progressive levy on taxable income sufficient to raise revenue equal to what Commonwealth Government expenditure on aged care would be following the adoption of the recommendations made by the Royal Commission (including the assumption that care is not means tested but that Commonwealth assistance for accommodation costs in residential aged care is means tested). • **Scenario 2C:** An alternative consideration is if individuals only have a higher additional marginal tax rate after a certain age (40 in this example) to cover the costs of aged care. As such, the levy would only apply to individuals over 40 and those under 40 would effectively have a 0% levy.

Aged Care Levy Variant	Description
Royal Commission Variant	• **Scenario 3A:** A flat rate levy sufficient to raise revenue equal to what Commonwealth Government expenditure on aged care would be following the adoption of the recommendations made by the Royal Commission (including the assumption that care and Commonwealth assistance for accommodation costs in residential aged care are not means tested). • **Scenario 3B:** A progressive levy on taxable income sufficient to raise revenue equal to what Commonwealth Government expenditure on aged care would be following the adoption of the recommendations made by the Royal Commission (including the assumption that care and Commonwealth assistance for accommodation costs in residential aged care are not means tested). • **Scenario 3C:** An alternative consideration is if individuals only have a higher additional marginal tax rate after a certain age (40 in this example) to cover the costs of aged care. As such, the levy would only apply to individuals over 40 and those under 40 would effectively have a 0% levy.
Sensitivity Analysis	• The following sensitivities were tested over a short-term (five year) stress but unchanged assumptions thereafter. They have been designed in this way to reflect that the levy may be adjusted based on emerging experience after five years. As a result, if the stressed outcomes do emerge over the first five years and, at that point, are then expected to continue, additional incremental changes to the long-term levy can be made then: • Using Budget COVID-19 tax revenue impacts for the next 4 years • Increasing the number of people needing aged care by 10% for the next 5 years • Increasing Unit Costs by 10% for the next 5 years • Ensuring that the accumulation of funds at the end of the 5-year period are sufficient to meet 3 months of expected costs

Baseline scenario
Indicative levy rates on personal income

- estimated total public cost levy is 2.61%
- additional marginal levy rates (that is, they apply to each dollar in the tax band earned over the band's lower threshold), where the fixed tax component for income earned below that threshold is subject to the rates for the lower bands:

Income tax bracket	Baseline
Up to $18,200	0.0%
From $18,201 to $37,000	2.1%
From $37,001 to $87,000	3.7%
From $87,001 to $180,000	4.2%
Above $180,000	5.1%

- these rates preserve the proportional relationships between tax bands that already exist in the present income tax system
- because no additional funds are expended under this scenario than under current policy, the Government could, in a revenue neutral way, reduce marginal tax rates in the various tax bands.

Reform scenario
Indicative levy rates on personal income

- estimated total public cost levy is 5.4%
- additional marginal levy rates (that is, they apply to each dollar in the tax band earned over the band's lower threshold), where the fixed tax component for income earned below that threshold is subject to the rates for the lower bands:

Income tax bracket	Baseline	Reform (Gross)	Reform (Net)	Reform (Alternative Net)
Up to $18,200	0.0%	0.0%	0.0%	0.0%
From $18,201 to $37,000	2.1%	4.4%	2.3%	1.2%
From $37,001 to $87,000	3.7%	7.6%	3.9%	2.1%
From $87,001 to $180,000	4.2%	8.7%	4.5%	2.3%
Above $180,000	5.1%	10.5%	5.5%	2.8%

- these rates preserve the proportional relationships between tax bands that already exist in the present income tax system
- 'Net Levy' rates reflect the differences between the Gross Levy rates in the reform scenario and the levy rates in the baseline scenario, reduced to maintain revenue neutrality
- 'Alternative Net Levy' rates generate only 52% of the additional costs of the recommended reforms (in line with the current distribution of financing between personal income taxpayers and other elements of the tax base)

Cash accumulations (reserves)

- A long-run PAYG levy would need to be set at a level that can be expected to be sufficient to pay for all relevant aged care costs over the long term. Because of **differences in cashflow timings** – in particular that aged care costs are expected to grow more quickly than taxable income - the introduction of such a levy would result in accumulations at different times.