Coordinating Healthcare and Pension Policies: An Explorative Study

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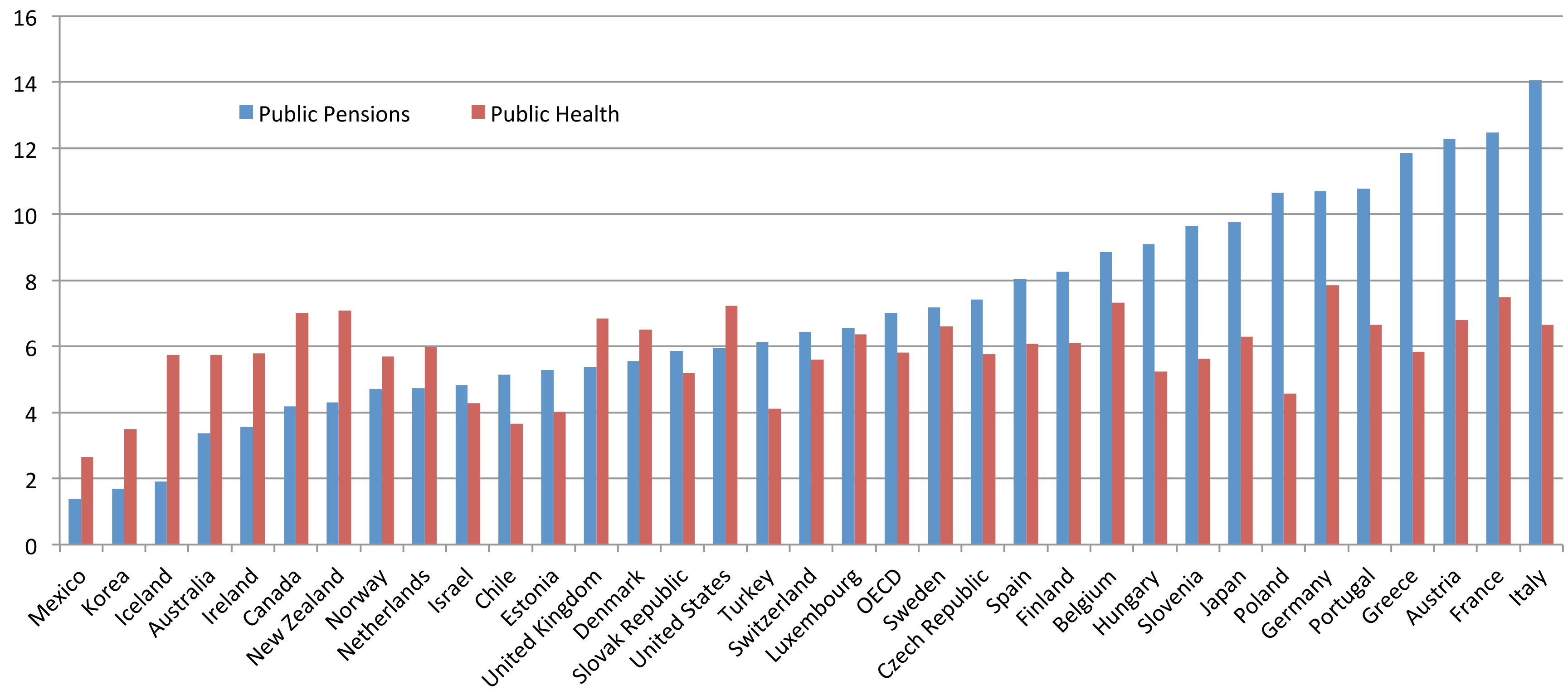
Outline

- Introduction
- Rationale
- Areas of Coordination
- Case Study: India
- Concluding Remarks

Introduction

- During the retirement period, an individual requires a *bundle* of goods and services which is adequate, accessible, and affordable.
- This *bundle* of goods and services includes what pensions in financial terms can purchase, plus healthcare services.
- With ageing, each person requires this bundle for a longer period (i.e. proportion of life-time spent in retirement increases).
- OECD average public expenditure of social spending was 20 percent in 2009, of which healthcare and pensions accounted for 14 percent.
- If private spending on healthcare and pensions is included, OECD spends on average a fifth of its national income on managing healthcare and pensions.

Expenditure on Public Healthcare and Pensions in OECD, 2009



OECD, 2010

Introduction

- In Asia, the resources devoted to pensions and healthcare programs were relatively much lower. The average public expenditure on healthcare programs was 3.7 percent of GDP and public expenditure on pension programs is 1.7 percent in 2009.
- This is a significant share of national income to be devoted to meeting age related expenditure, and avenues to manage these resource costs better must be explored.
- The analytical concept used in this study is *economies of scope* (Panzar and Willig 1977, 1981). While economies of scale refers to reducing the average cost of a particular product, economies of scope refers to lowering the average cost for *two or more* related products.
- This study is interested in exploring to what extent policy coordination between healthcare and pensions can better manage the resource costs of ageing.

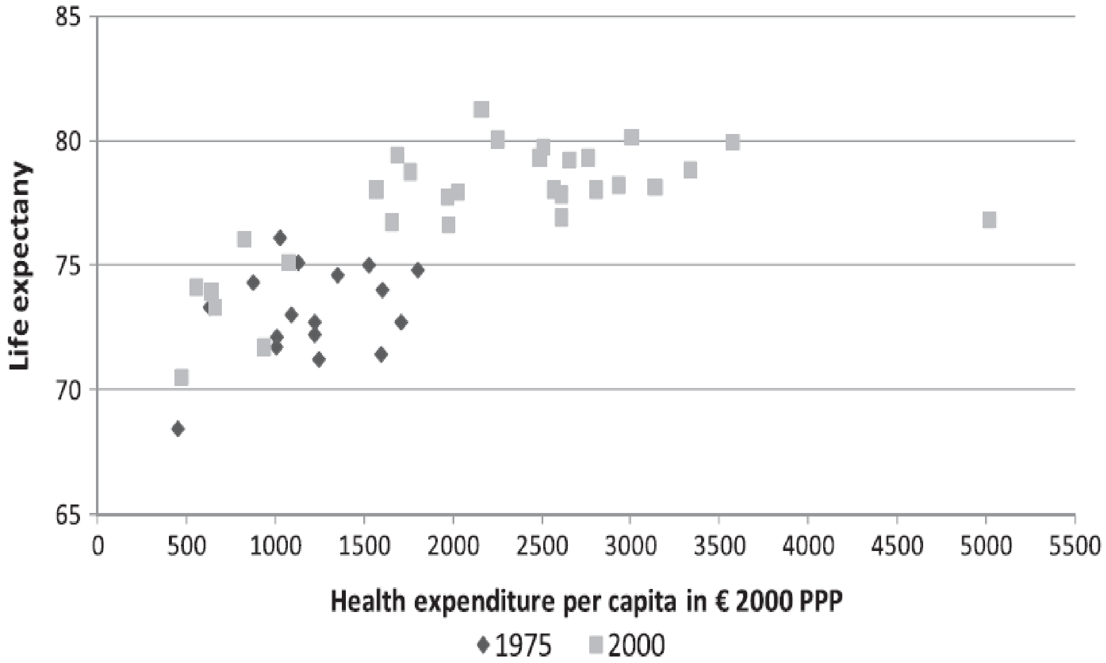
Introduction

- In economics, policy coordination has been approached in terms of the need for coordinated multilateral efforts to tackle crises or coordination of macroeconomic policies (Stewart, 1984; Putnam and Bayne, 1984)
- More recently, Christopher Sims (2013) has made the case for the lack of coordination between monetary and fiscal policies in macroeconomic models. Particularly, in modelling of real and financial sectors.
- This study takes a much narrower view of policy coordination. As there are many linkages between healthcare and pension policies, and their joint impact on crucial public policies, the focus is to explore aspects between the two that could a) better manage ageing costs b) reduce the total resource cost of ageing.
- It is important to note that coordination does not imply harmonization or integration. Pensions are for old-age; health care needs are throughout life. There are only certain aspects that merit coordination.
- Policy coordination can be thought of in terms of *design*, *implementation, governance and regulation.*

Rationale for Coordination

Impact on Longevity

•There is a positive relationship between income and healthcare expenditure, and healthcare expenditure increases disproportionately with advances in longevity. For example, Japan's healthcare spending for those aged above 65 is 4.7 times that of below 65 (Takayama, 2010).



Rationale for Coordination

- There is a complex relationship between pension and healthcare costs from the perspective of the economy as a whole. In many countries, including rapidly growing economies of China, India, and Indonesia, lifestyle diseases are growing and they are affecting the working age population at a younger age.
- There may be savings on pension costs if those afflicted with life style diseases experience premature deaths. However, the loss in productivity to the economy because of their premature death and the rise in healthcare costs due to lifestyle diseases could outweigh savings in pension costs (Lee and Mason, 2002)
- Thus, both pensions and healthcare needs to be combined to meet the needs of the elderly. Such a combination is also essential for estimating the fiscal costs of the bundle of services needed, and the economic implications of financing these costs

Rationale for Coordination

Mitigating the adverse impact of ageing on economic growth

•*D*eclining fertility rates will cause labor-force-to-population ratios to rise as the shrinking share of young people will more than offset the skewing of adults towards the older ages (Bloom et al, 2010).

•Coordination between investment strategies and policies of healthcare and pension funds can also help increase the long-term trend rate of economic growth in an economy, the primary macroeconomic variable providing income security for both the young and the old. (Barr and Diamond, 2008).

•Policy responses such as increments in the institutional retirement age needs to be implemented gradually as it has important implications for labour markets, as well as for consumption, savings, and economic growth. An individuals decision to exit the labour force will also depend on pension and healthcare provisions. Coordination can help facilitate this transition.

Rationale for Coordination

Achieving Policy Coherence

- Policy Coherence can be thought of in terms of clarity and consistency in using instruments to achieve a goal
  - Also across programs
- For example, some individuals are targeted by more than one state-financed healthcare program
  - Tax treatment of health insurance and pension products
- There are differences in the actuarial dynamics of healthcare and pension costs, and each can potentially give rise to contingent liabilities on the state.
  - Policy coordination can help facilitate appropriate trade-off between competing priorities (on social expenditure).

Operational Areas for Coordination

- *Coordination In Design*
- *Coordination In Regulation*
  - Tax Treatment
- *Coordination In Implementation*
  - Collection of Contributions
  - Record-Keeping and Administrative Functions
  - Investment Management

Operational Areas for Coordination

Coordination in Collection of Contributions

- There are two basic models for organizing administration of public pensions – *social insurance model*, and *benefit payment model* (Ross, 2011).
- The social insurance model handles all major functions including collection of contributions, and distributing of benefits to members (Examples: France, Germany, Brazil, Mexico, Japan, and Thailand)
- The *benefit payment model* on the other hand relies on the tax administration system for collection of member contributions, but pays beneficiaries directly (United States, Canada, United Kingdom, Sweden, and Australia).
- The investment function in this model is either handled in-house such as in Sweden, or is sourced to another organization such as the Treasury Department in the United States.

Operational Areas for Coordination

- Predictably, a parallel collection system is likely to be more expensive, as integrated collection systems have lower administrative costs (Ross, 2011, p7).
- In Singapore, and Malaysia, the mandatory provident fund contributions are partly channeled for health care. Two separate organizations collect healthcare and pension contributions in the Philippines, both using mandatory risk-pooling insurance methods.
- Korea has moved towards a single agency to collect contributions for both healthcare and pension programs in 2012. Investment management is however separate.

Operational Areas for Coordination

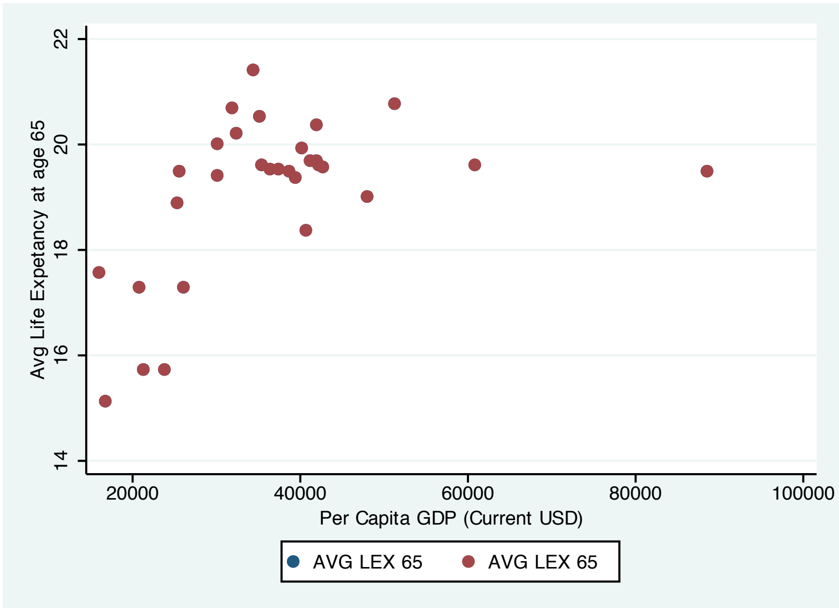
Coordination in Administrative Functions: Data and Record-keeping Activities

- There are considerable *economies of scale* that social security organizations can realize from coordination in administrative functions – particularly in data and record-keeping activities.
- A centralized collection system and record-keeping activities reduces the transactions cost, hassle costs and most importantly eliminates wasteful expenditure on duplication of services.
- Further, such coordination facilitates totalization agreements, and portability of pension and healthcare benefits.

Operational Areas for Coordination

Coordination in Investment Management

- As there is a positive correlation between health status and income, without risk pooling, inequalities that exist in the pre-retirement period are perpetuated, if not accentuated, during retirement.



Operational Areas for Coordination

- An important question that needs to be explored, is there a case for a combined healthcare and pension fund, especially if both funds have the same investment mandate.
- The standard argument in favour of multiple funds is that it reduces monopoly power of a fund; promotes competition which forces funds to reduce their administrative costs; and reduces systemic risk.
- This argument however rests on the assumption that members of the healthcare or pension program have the freedom to choose from competing funds. If funds are required to have similar investment mandate or exposure to asset classes – there may be little effective competition as each is constrained by regulation, and will offer similar returns.

Operational Areas for Coordination

- If however fund managers are allowed to compete by offering packages that differ in some dimensions, the choice and competition could give funds an incentive to be cost effective, along the lines that standard economic theory suggests (Blomqvist, 2011). However, encouraging effective competition among fund managers has proved to be difficult, as experience in Chile and elsewhere suggests.
- This is however not the case in healthcare and pension plans in most Asian countries. Individuals do not have the choice to select amongst multiple funds. There is a separate health insurance fund and a separate pension fund that manages the contributions and accumulated balances of the respective programs.

Operational Areas for Coordination

- Both pension and healthcare funds have different liability structures, and the variance in benefit payments. This is due to the inherent stochastic nature of healthcare shocks, and the ensuing expenditure.
- The extent to which the differing variance in expenditure and liabilities in healthcare and pension programs, *ex-ante*, impacts the investment decisions of their respective funds, there is a case to consider the separate investment management of healthcare and pension funds.

Operational Areas for Coordination

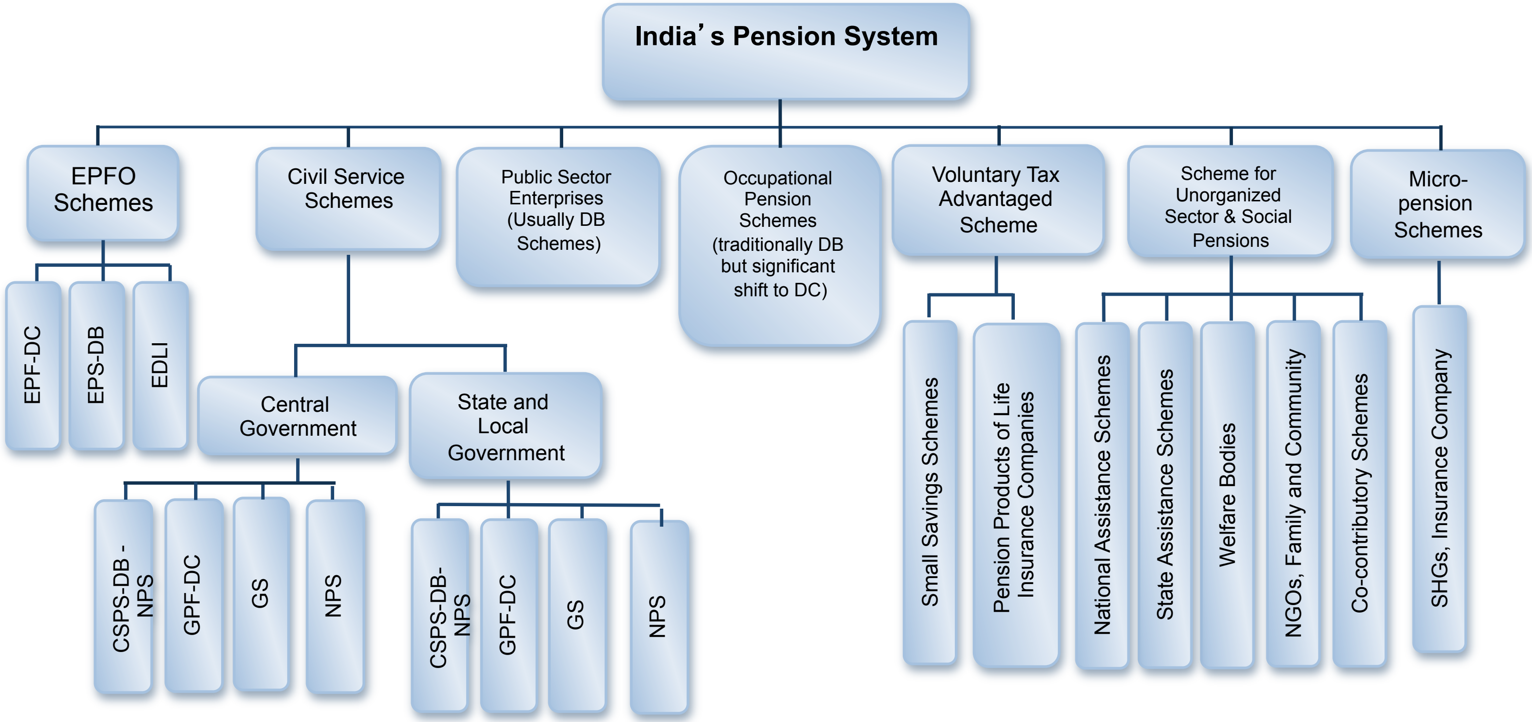
Co-ordination of Tax Treatment

- The tax treatment of retirement and healthcare financing instruments need to be co-ordinated to ensure a level playing field among various instruments, and amongst various providers.
- Many countries including India, Singapore, and Thailand offer uneven tax treatment to many retirement and healthcare financing products, which affect contemporaneous consumption choices, and may divert disproportionate share of resources towards either financing healthcare or consumption expenditure.
- This could have significant incentive effects. Thus, unequal tax treatment among instruments and providers could encourage individual and fund behavior which could increase combined costs of pensions and healthcare.

Case Study: India

- The paper discusses case studies in India, Malaysia, Philippines, Singapore, Thailand, Vietnam. This presentation offers an overview of coordination arrangements in India
- India's Healthcare and Pension System has evolved over the past 50 years. Consistent with India's Federal Structure many schemes have been introduced, with limited coordination amongst them.
- There are both intra-program (between various components of India's health or pension system), and inter-program coordination issues.

Case Study: India



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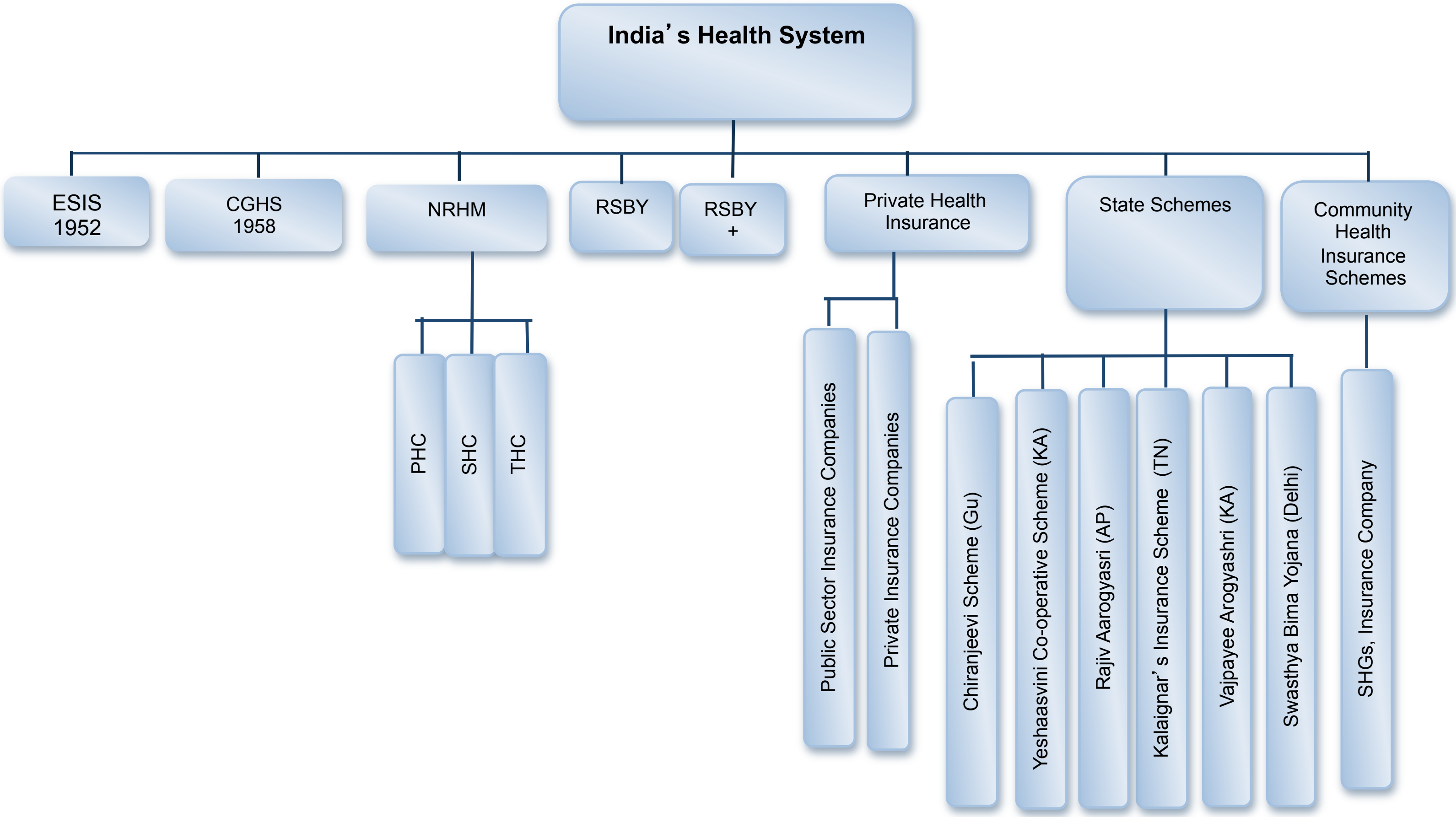
Case Study: India



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Criteria	Policy Coordination in India
Design Features	• Healthcare programs introduced by central, state, and local government without coordination have resulted in duplicating benefits; • Each healthcare program issuing its own bio-metric identification card to a common group of beneficiaries; • Variation in adequacy of health benefits or pensions in many programs (that require co-contributions from state governments) due to varying fiscal capacity of state governments.
Regulation & Governance	• There are no regulators of healthcare or pension programs at an all India level; Pension Regulation Bill, PFRDA, has been in Parliament over 7 years. • Programs are governed by Ministry of Health and Family Welfare (MoH), Ministry of Labor and Employment (MoL), Ministry of Finance (MoF), Minstry of Communication & Information Technology (MCI), and State governments with limited expertise, competence, and coordination amongst them to manage programs. • For example, ESIS – social insurance scheme for formal sector workers in run by the MoL without any input or consultation with the MoH that manages other schemes.

Criteria	Policy Coordination in India
Contributions	• Contributions to various central government sponsored pension programs are managed separately (NPS, EPFO), and healthcare programs (ESIS) are managed separately without realizing any gains from economies of scale and scope. • State level programs rely on complex Third Party Agents (TPAs) to collect and manage contributions, often increasing transaction costs.
Tax Treatment	• There is uneven tax treatment amongst pension and healthcare insurance (savings) products. This may result in allocation of resources in an sub-optimal manner to manage the costs of ageing.
Investment Management	• The central government sponsored pension and health programs have similar investment mandates, i.e. regulation on asset class exposure. These are however managed separately. • Recently, individuals have been given more choice in investing in pension funds with different risk preferrences
Policy Coherence	• There is limited Policy Coherence amongst healthcare and pension programs, and even between various health and pension programs.

Concluding Remarks

- The need to minimize combined resource costs to the economy of pensions and healthcare has become increasingly stronger.
- Ultimately, healthcare and pensions is a *bundle* of services that the elderly would need to have access to. Thus, minimizing the total resource costs of the *bundle* – should be an important policy priority. These costs then can be financed through different instruments, with risks and burden borne by different groups in the society.
- This paper examined the rationale and the challenging context in which coordination between the two could assist in managing their combined costs. This is however a new area and therefore, this study is exploratory.
- The paper discussed four areas of such coordination: collection of contributions, data and record-keeping activities, investment management, and tax treatment.

Concluding Remarks

- Several country case studies were provided, though only India is highlighted in this presentation.
- As many Asian countries have limited fiscal space to finance social expenditure, innovative solutions relying on the combination of the public, private, and not-for-profit sector, in the provision and delivery of the bundle of services will be needed.
- For higher income groups, private market solutions for providing the requisite bundle of services (with some choice) is feasible and should be explored.
- As research progresses in this area, additional ways in which coordination between pension and healthcare policies could minimize combined costs may become apparent. Rigorous empirical evidence-based policy oriented research in this area therefore merits consideration.