LASA
LEADING AGE SERVICES AUSTRALIA
The voice of aged care

CONSULTATION PAPER 2: FINANCING

Submission to the Royal Commission into Aged Care Quality and Safety
4 August 2020

A strong voice and a helping hand
for all providers of age

Leading Age Services Australia

Leading Age Services Australia (LASA) is a national association for all providers of age services across residential care, home care and retirement living/seniors housing. Our purpose is to enable high performing, respected and sustainable age services that support older Australians to age well by providing care, support and accommodation with quality, safety and compassion – always.

LASA's membership base is made up of organisations providing care, support and services to older Australians. Our Members include private, not-for-profit, faith-based and government operated organisations providing age services across residential aged care, home care and retirement living. 55% of our Members are not-for-profit, 37% are for-profit providers and 8% of our Members are government providers. Our diverse membership base provides LASA with the ability to speak with credibility and authority on issues of importance to older Australians and the age services industry.

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Summary

1. The Commission's consultation paper considers a variety of different financing options, and those options are further explored in this response. However, we ultimately believe a relatively simple approach is the most likely to succeed in raising the required funds for aged care reform.

2. User payments should be increased in various ways to increase contributions from those who can pay more. Noting that the amount that can be raised this way is unlikely to be enough to cover more than a small proportion of the costs that the Commission has envisioned with the potential for further challenges in the future as home ownership rates fall.

3. What cannot be funded through reasonable increases to user payments should be funded through a levy on personal income. This could be via a simple rate based levy. Alternatively, the levy could be described as a social insurance premium, with a revenue target approach and linked Commonwealth and social insurance contributions. However, this 'social insurance' approach may make implementation harder rather than easier.

4. Government should support insurance and equity release schemes to help people pay for higher level care, as well as the increased user contributions.

5. The focus of financing reform should be on raising the additional funding needed rather than changing the way that aged care as a whole is financed.

6. Given anticipated budget deficits due to COVID-19 and the large quantum of additional funds contemplated in the consultation paper, the Commission will need to be as clear and explicit as possible about what needs to be implemented by when.

7. It may be prudent for the Commission to take the initiative of identifying the highest priority reforms rather than leaving this to be determined in the Government response.

8. More complex financing models involving broader tax reform could be considered as a mechanism for funding the medium priority recommendations.

1.0 Features vs labels of financing options

9. The differences between tax, social insurance and private insurance models are largely a matter of how these schemes are designed.

10. Tax and social insurance premiums can both be collected on a compulsory basis from varied sources. Revenue raised can be quarantined in specific funds or left in general revenue. Rates can be fixed or set on a revenue target basis. Funded services can be delivered privately, by government, or through private insurers as intermediaries.

11. Private insurance offers the potential for contributions to be voluntary, but can also be made effectively mandatory through arrangements like the Medicare Levy Surcharge.

12. Importantly, tax, social insurance and private insurance all offer mechanisms for sharing the cost of aged care across the community, in contrast to user pays options which focus the burden of paying for aged care on those who need care.

13. It is true that certain characteristics are more commonly associated with particular labels. For example, social insurance is more likely to mean a pre-funded, quarantined, and revenue

target based funding. Whereas tax financing is more likely to be pay as you, left in general revenue and have a fixed rate.

14. However, from LASA's perspective it is better to directly address the features that we want the financing system to have rather than focus on how that system should be labelled.

Features vs labels

The differences between tax, social insurance and private insurance models are largely a matter of how these schemes are designed.

Certain characteristics are more commonly associated with particular labels, but in LASA's view it is better to focus on the desirability of particular characteristics before turning to which label to apply.

2.0 Considerations for the design of a good financing system

15. In previous submissions LASA has argued the following issues need to be considered in designing financing arrangements:

- Sharing/equity – the cost of impairment should be shared widely and fairly, so that those unfortunate enough to have very high needs are not burdened by very high costs.
- Consistency – there should a consistent approach to covering the costs of impairment regardless of the type of services that a person needs.
- Progressivity – when the costs of aged care are shared this should take into account the fact that some people are able to contribute more than others, whether that is through the tax system or user payments.
- Flexibility – financing arrangements should allow for some variation in costs from service to service and region to region noting that differences in local costs structures and individual preferences will be impossible to fully account.
- Behavioural effects /efficiency – arrangements for allocating costs need to take into account the effects of any arrangements on behaviour which may in term affect the efficiency or effectiveness of the aged care system.

16. Some further considerations could also be added to the existing list:

- Adequacy – somewhat obviously, any financing arrangement needs to be capable of raising enough funds to pay for an appropriate level of care
- Stability, predictability and buoyancy – sources of funds should be reasonable stable, capable of being predicted and sufficiently buoyant to cover increases in the cost of aged care
- Community acceptance / political feasibility – any funding arrangement needs to be sufficiently acceptable to the broader community to be passed into law.
- Intergenerational equity / sharing of costs – It is useful to emphasise that the principle of sharing costs should take into account intergenerational sharing of cases in addition to sharing costs within a cohort.
- Non-substitution – where aged care services substitute for services that a person would otherwise have had to pay for themselves any funds that are freed should be redirected towards aged care.

__Considerations for the design of a good financing system__

LASA believes that the design of a good financing system should consider:

- *equity/sharing of costs;*
- *a consistent approach to fees across care types,*
- *progressivity; flexibility to respond to local factors;*
- *appropriate behavioural effects / efficiency;*
- *adequacy;*
- *stability, predictability and buoyancy;*
- *community acceptance;*
- *intergenerational equity; and*
- *non-substitution of public funds for existing private expenditures.*

3.0 What are we are trying to pay for?

17. A key issue for the design of any financing system is what it will be financing.

18. The Commission's paper appears to consider wholesale changes to aged care funding arrangements as well as more modest reforms targeted at paying for an expected increase in costs.

19. LASA's view is that it is better to focus on how to finance the additional expenditure required in the first instance.

20. Major shifts in the incidence of existing aged care will almost inevitably lead to legitimate concerns about people having to pay for aged care twice.

21. For example, aged care is largely financed through taxes on existing workers. Generations currently receiving aged care have already paid for the aged care of the generations that came before them. So asking them to also pay for their own aged care now can be argued to involve asking them to pay twice.

22. However, people cannot reasonably say they have already paid where the funds are being used to pay for a higher standard of services than has previously been available. Additional costs due to the need to provide services to a larger number of people for a longer period of time also arguably falls into the category of funding a higher service level.

23. More generally, people are much more likely to accept paying more in the context of getting more rather than being asked to pay more for something that they already believe that they are entitled to.

24. We are not suggesting that the Commission completely rule out any change in the financing of existing aged care expenses, but focusing on wholesale shifts in existing financing arrangements could easily distract from the immediate and pressing problem of how to pay for reform and other anticipated cost growth.

What are we trying to pay for?

LASA believes that financing reform should mainly focus on how to fund reforms to increase the level and quality of aged care, rather than looking at wholesale changes to the way that we finance existing service levels.

4.0 Prioritising recommendations

25. The Commission should consider whether it would useful to separately identify high and medium priority recommendations to help address the risk that the community (or the government) is not willing to finance all of the Commission's recommendations.

26. LASA believes that there is a very real possibility that the Government will not be willing to commit an additional $20 billion a year to aged care regardless of the Commission's recommendations, especially in the context of the COVID-19 crisis.

27. Providing high and medium priority recommendations would allow the Commission to make clear its own views of which recommendations should be prioritised rather than allowing this to be decided by the Government's response.

28. High priority recommendations could be funded through relatively simple financing mechanisms while medium priority recommendations may require more ambitious financing reform.

Prioritising recommendations

The Commission should consider identifying high and medium priority recommendations with different approaches to financing to address the risk that the Government may not be willing to provide an additional $20 billion to aged care.

5.0 Who should pay?

29. Much of the debate about how to finance public services ultimately boils down to the question of who should pay. As such, LASA believes it is useful to address this issue directly.

30. As the Commission outlines, aged care is largely funded through Commonwealth taxes. Given the nature of the Commonwealth tax base, this largely means working age people pay for the care costs of older generations, with the expectation that their own costs will be paid for by future generations.

31. There are a number of different groups that could be targeted to raise the additional revenue needed to fund a higher level of aged care.

5.1 Workers

32. The simplest option is to finance additional spending through increased taxes or social insurance levies on people of working age, through something like a higher Medicare levy. This can be done progressively or at a flat rate.

33. This option is reasonably equitable from an intergenerational perspective as the workers who would be contributing more can also expect to receive a higher level of services. It does leave older workers and retirees much better off because they will receive the benefit of increased services without having had to pay for them. But this gain is at the expense of past rather than future generations.

34. There may be some concern with increasing the level tax or tax like levies paid by workers, particularly in the context of shifting demographics that mean fewer working age people relative to non-working age people.

35. Aged care costs are likely to grow faster than personal income, so even if the costs are initially covered by a levy on personal income, the rate will need to increase over time to keep pace.

5.2 All consumers

36. The incidence of aged care costs could also be spread more broadly by taxing consumption through an increase in the GST rate, or a broadening of the GST base.

37. This approach would mean that even those who have already retired would pay some of the cost of increased service levels, but only if they do not receive other payments in compensation, such as an increase in the pension.

38. A consumption tax cannot be levied at a progressive rate, but it is technically possible to achieve progressivity by using some of the additional revenue raised to increase transfer payments to different households or modify other taxes. In theory, this approach can actually deliver more precise progressivity than simply levying a progressive rate on income tax.

39. Any effort to increase the GST has proven extremely politically difficult historically. Increasing the GST to pay for a federal expense would add a further complication given the revenue is currently dedicated to states.

40. Previous discussions about increasing the GST have primarily been in the context of a tax mix switch, with either personal or corporate income tax. Thus much of the opposition has come from groups that are concerned that the change will be regressive (i.e. it will result in low means groups paying a greater share of tax).

41. These groups that previously opposed a GST increase may be more supportive of an increase in the context of paying for an important government service, particularly if some of the revenue is also used to increase transfer payments.

42. While some groups may still oppose the increase in taxes to fund additional spending, they would also probably be opposed to an increase in income tax.

43. From a technical perspective, an increase in the GST could be a fairer and more efficient way of funding higher levels of aged care than a tax or levy on personal income.

44. However, from a pragmatic perspective it would be very risky to make increases in aged care service levels contingent on Australia's ability to strike an unprecedented bargain to increase the GST.

45. Any recommendation of this option would need to include discussion with the relevant broader stakeholders in the business, employment and social services sector.

5.3 People in care

46. As an alternative to funding aged care from the general community, costs can be covered specifically by those receiving care, noting that these people are the major beneficiaries of any change in aged care funding.

47. Many people in care have significant assets that would allow them to contribute much more than they currently do to the cost of aged care.

48. This can be achieved in various ways including:

- increased co-payments for lower level services like CHSP,
- more rigorous means testing, particularly in regard to the treatment of a person's principle place of residence,
- making fee caps proportional to means rather than fixed,
- more flexible basic fees in residential care, and
- stricter application of the principle that aged care should only pay for additional needs due to impairment.

49. There are also ways that the potential effects of these additional fees on behaviour could be mitigated, such as using deferred payment mechanisms or collection of fees via retention from residential accommodation deposits.

50. Without going into the specifics of these options, there should be some role for increased user payment in financing aged care, to allow greater flexibility, improve consistency between different types care and make contributions more uniformly commensurate with ability to pay. Other mechanisms, such as reverse mortgages or a way to preserve the proceeds of home sales tax free[1] may also help people to fund any increase in user contributions to aged care.

51. It might be reasonably expected that people who are well off put aside some funds to cover the cost of aged care. However, the base from which these funds can be drawn is relatively narrow.

52. Technically, the significant equity held by many older households in their place of residences is likely to be enough to pay for all but the highest levels of care. However, it is arguably horizontally inequitable to ask some households to pay these significant additional costs because they happen to need care as a result of factors beyond their control. There is also a risk that with very high user fees, people will simply refuse care or attempt to stay longer in other services, such as hospital system, which may be cheaper from a user payment perspective but much more expensive socially.

53. Any increase in user fees must take care not to disadvantage low means households, noting in particular the number of older households who are renting, or likely to be paying off a mortgage will increase significantly in the coming decades.

[1] See proposal in Grant Thornton, 2019, The redesign of the aged care sector in Australia – Funding

5.4 Older people in general

54. If there are concerns with placing too much of the burden on frail older people in care, there are various mechanisms that can spread the cost across older cohorts more generally (noting that younger cohorts would also pay themselves as they age).

55. Voluntary private insurance markets can theoretically spread any increase in costs over a broader population. However, there has been little development of such markets historically. That might change if the financial burden of having to pay for aged care goes up drastically. However, this would take time, and likely not cover people who are likely to need care in the near future.

56. On the tax/levy side, an increase in land tax that included the principal place of residence would place the incidence on older generations, who typically own more real-estate.

57. Taxes (or social insurance levies) could also be linked to the benefit stage of superannuation or increased aged care expenditure could be financed through tightened means testing of other benefits such as the pension.

58. An estate tax is another way that aged care can be financed in a way that allows each cohort to pay its own costs.

59. Financing options that target older generations are the most broadly based in a lifetime sense, because fewer cohorts avoid having to contribute. The land tax option would also be a relatively broad based and efficient tax in a more conventional sense. However, other options such as a levy on superannuation or an estate tax would be relatively narrowly based, with room for debate over their efficiency.

60. Each of the options described above relates to policy changes that have traditionally been extremely controversial. It is possible that there would be greater political support for these options in the context of funding the costs of increased aged care services. However, as with the option of raising the GST, it would be very risky to make aged care reform contingent on successfully achieving these changes. It would also be necessary to involve broader stakeholder groups in the discussion of these arrangements.

5.6 State governments

61. Another option for paying for the costs of higher levels of aged care is to ask for contributions from state governments – noting that there should be savings from reduced hospitalisations if the level of clinical care available in the community and residential aged care services increases.

62. This ultimately means the incidence on state taxpayers, which reflects largely reflects a combination of property owners and renters (through land tax and stamp duty), workers (through payroll tax), and consumers (through the GST).

5.7 Which option is best?

63. Arguments can be made for and against asking each of the groups discussed above to pay more to increase the level of age care services that can be provided.

64. There is certainly a role for greater user contributions. However, we are unsure of both the equity and practicality of funding anything close to 50% to 100% increase in aged care costs from recipients of aged care services.

65. We believe – as a back of the envelope calculation – that it might be possible to raise an extra $3b per year from users of the aged care system, but even this would involve making some difficult choices. Even if we are being overly pessimistic and an extra $6b could be raised this would leave a significant amount to be funded via other mechanisms.

66. State Governments could also likely making a small contribution, though it should be noted that they already contribute to aged care through running state operated age care services at a loss.

67. In other words, there will inevitably need to be some broad based financing of aged care. The choice of which group these funds should be raised from is really more a question of broader fiscal and tax policy than aged care policy.

68. If the Commission is considering recommending these broader financing options then it will be necessary to bring the relevant stakeholders into the discussion, including treasury departments, state governments, business groups, the union movement more broadly, and the social services sector.

69. Absent a grand bargain being made in advance of the final report, we would prefer an increase in personal income tax (or associated levy) to fund at least the core part of any increase in aged care investment, as we believe it is the surest path towards achieving the additional funding that the sector needs.

70. From a LASA perspective the critical issue is that financing reform supports and facilitates access to the services that the older people in care need rather than creating a separate controversy that acts as a barrier to reform.

Who should pay?

There is significant potential for some of those receiving care to pay more, particularly through increased co-payments for entry level services, more rigorous means testing, the application of means based rather than flat caps on fees, and greater freedom for people to pay more to get better care in residential care.

However, it is unfair and impractical to ask those unfortunate enough to need to high levels of care to fund the full cost of delivering better aged care services.

The wider community will need to play a major role in funding the additional costs of aged care. This can be most simply and safely achieved through an additional levy on people of working age.

There are also other options that would have all consumers pay, or all older people rather than just those receiving care, but these approaches carry the risk of delaying if not derailing reform unless an unprecedented bargain can be struck.

Any more to pursue more complex reform of financing arrangements would need to involve the broader community stakeholders that would be required to pay, rather than just the aged care sector and representatives of older Australians.

6.0 Prefunding vs pay as you go

71. LASA does not believe that shifting to a prefunding system is likely to be feasible, even if it only covers the additional expenditure needed to implement the commission's recommendations.

72. While there are some advantages to a pre-funding model once it has been established, it means, as the Commission points out, that some cohorts will need to pay for their own care as well as the care of older generations that have not had time to prefund their own costs.

73. One of the primary reasons for exploring prefunding would be to address future increase in the dependency ratio, but with the baby boomers at or near retirement age it is too late for Australia to obtain this benefit. Moving to a pre-funding approach now would only exacerbate the rising dependency ratio in the coming decades.

74. Theoretically, it would be possible to move to a prefunding model for generations with the time to save, while having older cohorts fund their additional unmet care needs through an estate tax. This would allow a move to at least a partial pre-funding model while avoiding any age cohort needing to pay twice.

75. A final top-up payment also addresses another weakness of pre-funding models, which is that the cost of care for a cohort may be higher or lower than expected at the point where that cohort ceases making contributions. In the case of insufficient funds, the difference would likely need to be made up through general revenue. It is not clear what would happen in the event that there was excess funds.

76. Unfortunately, any discussion of an estate tax has previously proven politically difficult in Australia. We doubt that this option will prove acceptable to the community as a mechanism for funding aged care.

77. The two potential benefits that the Commission discusses in terms of quarantining funds and achieving a revenue target can both theoretically be achieved through a pay as you go scheme, whether the payments are badged as tax or social insurance premiums.

Pre-funding vs pay as you go

LASA believes there would be little benefit and significant difficulty in moving from the current pay as you go approach to financing to a prefunding model.

7.0 Quarantining, shared contributions, and revenue targets

78. The Commission discusses the potential benefits of quarantining funds for aged care. However, for this to provide any real funding certainty other factors need to be considered.

79. Simply assigning the revenue from a particular tax to fund aged care is relatively meaningless if the Commonwealth agrees to also fund the difference between revenue raised and expenditure needed because the Commonwealth is free to lower its own contribution for whatever reasons it chooses.

80. It would be possible to impose some link between revenue raised and the Commonwealth contribution (e.g. the Commonwealth matches funds collected through the special levy). Another benefit of this approach is that it is much more difficult for the Commonwealth to reduce its commitment if this is in the context of a contribution.

81. However, basing funding on revenue raised would generally mean less certainty for the sector because revenue of any conceivable tax base is likely to be more volatile than Commonwealth decisions about aged care policy.

82. Most revenue bases would also probably grow less quickly than aged care costs, though there may be some exceptions such as land and inheritances.

83. There is a way to address the volatility of the revenue stream. Normally taxes are based on a fixed rate that remains the same from year to year, so the amount of revenue varies as the base changes. However, it is possible to have a revenue target set by policy and then vary the rate of tax or premiums levied each year in order to collect the amount needed. This is how local government rates are typically set.

84. This revenue target model works better when there is a closer connection between the people receiving the service and those making the payment because they are able to more directly see both the benefits and the costs.

85. The concept of variable social insurance premiums discussed in the Commission's paper is a revenue target approach, though revenue targets can also be applied through tax instruments. Even a private insurance pool to pay gap benefits is effectively a revenue target approach, albeit with more limited scope.

86. With a revenue target in place, there would be a much more meaningful association between expenditure and whatever financing instrument is used.

87. However, as with most of the other more innovative possibilities, there may be opposition to its implementation given it is a relatively novel approach to collecting revenue in Australia. Badging a revenue target approach as a social insurance levy may be one way to help people understand why this option differs from the approach taken to most taxes.

Quarantining, shared contributions, and revenue targets

It is worth exploring a revenue target approach to raising additional funds, with a link between revenue raised through the aged care financing instrument and general government contributions.

8.0 Non-mandatory contributions, private insurance and equity release

88. One key way in which the private insurance option differs from the others it that it can be a voluntary mechanism that allows people to make their own choices about the amount that they would like to set aside to pay for the risk that they need aged care.

89. People can purchase different levels of cover that suit their own preferences about the level of aged care that they would like to receive.

90. The option of voluntary insurance is closely linked to allowing increased flexibility in fees – though of course it would be possible for an insurance product to offer a top-up to home care packages to allow people to stay at home for longer. An insurance product could also exist to provide services to people who are waiting for a home care package to be issued to them.

91. It may be true that if higher user fees were introduced, people would be more likely to take out insurance to defray the cost of these fees. This would not assist those in care currently, but arrangements could be made to grandfather people who cannot access insurance because they are likely to need care very soon.

92. Other financing instruments can also assist in giving people more choice about the level of care that they receive by making it easier for people to unlock home equity. Making the Pension Loans Scheme more attractive may greatly assist with this.

93. One way to reduce the burden of private insurance on the weekly budgets of older Australians would be to allow that insurance to be paid for through an equity release product like the pension loans scheme.

94. Overall, LASA believes that voluntary private insurance markets and equity release products could allow a larger number of people to afford to purchase a higher standard of care. However, we would be reluctant to rely on a private insurance market to support people to pay for the cost of baseline aged care services given the failure of such markets to develop historically.

Non-mandatory contributions, private insurance and equity release

LASA believes that voluntary private insurance markets and equity release products could allow a larger number of people to afford to purchase a higher standard of care. However, we would be reluctant to rely on a private insurance market to support people to pay for the cost of baseline aged care services given the failure of such markets to develop historically.

9.0 Transitions

95. It is difficult to make specific comments on appropriate transitional arrangements without understanding the intended future model.

96. However, we can point to some important general considerations.

97. Firstly, aged care needs additional funding sooner rather than later, so the design of any future funding system needs allow for the funds to flow quickly.

98. Secondly, people should be given time to prepare for or a least recover from any significant increase in the costs that they are expected to pay. This is particularly true for older Australians who have little capacity to earn additional income or adjust their affairs to pay higher than expected costs.

99. We acknowledge that there is a degree of tension between these two points.

100. Thirdly, the Commission should give some consideration to the timing of the final report, which is now scheduled for just a few months before a federal budget. It is likely that the Government will wish to respond in that budget, which means that more complex financing

mechanisms that will require significant discussion with the broader community are unlikely to be possible to support the Government's initial response.

Transitions

Transition arrangements will depend on the proposed financing arrangements, but need to consider the need for additional funding sooner rather than later, the need to account for the ability of people to adjust to significant additional costs, and the federal budget cycle in the Commission's recommendations are being made.
