The Multipillar System for Health Care Financing:

Thirteen Good Reasons for Open Capitalisation Funds, Covering both Pension and Health Care Provisions

CeRM recommendation for creating a new tool, the Open Welfare Funds: open funds based on real capitalisation of contributions, dedicated to both pension and health care provisions, and linked to collective insurance coverage against major health risks (first of all lack of self-sufficiency)

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Abstract

Within welfare systems, health care is the expenditure that poses the most urgent problems for long term sustainability. Without policy interventions and structural reforms, its physiological tendency towards increases over Gdp will inevitably require access restrictions and cutting off of demand for services.

This paper highlights the need to renew the current health care financing scheme. In the presence of ageing populations and rising incidences of health care expenditures over Gdp, this scheme cannot remain fully in charge of the working income of active people (pay-as-you-go), if we want to avoid depressive effects on employment, investments and productivity. Such effects, besides hampering economic growth, would have a negative impact on health care itself, with resources becoming more and more scarce with respect to needs.

The financing scheme must become multipillar, with pay-as-you-go complemented by a private channel based on the real capitalisation of contributions. This channel would be capable of allocating savings, supporting productive investments and generating resources to be dedicated to health care.

The best structuring and concrete functioning of the private pillar is less clear and under discussion. This position paper puts forward an operational proposal: the open capitalisation fund for welfare should offer both pension and health care provisions through real accumulation of contributions on individual accounts, and should be linked to collective insurance coverage against major risks and lack of self-sufficiency.

This tool presents numerous positive characteristics, compared to the public pay-as-you-go monopillar as well as to a multipillar system in which the private component consists exclusively or mainly of insurance contracts. In fact, it is necessary to restrict the recourse to pure insurance coverage only to a limited group of treatments, because this kind of coverage is not equipped to deal with the dynamics of future expenses. As the difficulties American insurance companies are experiencing demonstrate, the pure insurance coverage ends up with the recurrence, in the private area, of the same defects as the pay-as-you-go in the public health care systems. Insurance pooling is not but a pay-as-you-go scheme applied over the group of insured members.

An open and conclusive debate is necessary.

The Italian population will age faster than many other European population. In 2007 the dependency ratio (the ratio between non versus working age people is 51.5 percent, against 48.6 in the Eu-25 and 49 in the Eu-15. This gap will likely increase. In 2050 the ratio will be 86.8 percent, against 77.1 in the Eu-15 according to the Eurostat central demographic scenario, and 94.3 percent against 83.1 in the Eu-15 according to the most intense aging scenario. This profound reshaping of the demographic pyramid will not only cause changes in the economic sector and in the society, but will also induce disproportionate flows of resources between generations will emerge, particularly in terms of financing of pension and health care systems.

1. Inadequacy of the Monopillar Paygo System

In Italy, pensions and health care are financed almost entirely on a pay-as-you-go basis, that means through resources taken yearly from the incomes of workers.
Considering the long term projections for pension expenditure (Ecofin) and health care (Oecd), together with Eurostat demographic projections, in 2050 every working age citizen will have to contribute an amount equal to 50 percent of per capita Gdp (today it is 30).
Even in the optimistic hypothesis of achieving the labour market goals set at the Lisbon and Stockholm European Councils, the burden on every employed person would exceed 70 percent of per capita Gdp. If instead the employment rates were to remain as they are today, this burden would be much heavier, close to 100 percent, because for every employed person there would be 1.5 persons (children and the elderly) to be supported (today 0.85).
These huge disproportions will take place, to different extents, in all industrialized countries, and are bound to produce distorting effects on labour markets, investments and production.
Pay-as-you go financing schemes can no longer rely any more on the so-called Aaron's theorem, which, given a young and growing population, states that yearly contributions paid by all working people were the best possible solution for both transferring resources across generations (pensions) and sustaining universalistic provisions (health care systems).

2. Development of the Complementary Capitalisation Pillar

In order to rebalance the pay-as-you-go scheme, for both pensions and health care, it is necessary to develop a complementary pillar based on real capitalisation, that provides resources for facing future expenditures through the accumulation, supported by tax relief, of long term investments on individual accounts.
In Italy, the debate on the limits of pay-as-you-go schemes has focused almost exclusively on pensions. For these, even though the private pillar still displays an insufficient dimension and its normative framework is far from complete, a certain awareness of the problem has been reached. On the contrary, for health care the road to a solution still appears long, despite the fact that the multipillar diversification appears more necessary than for pensions.
In Italy, while public pension expenditure is slowly stabilising over Gdp, public health care expenditure, without policy correction, could potentially double or more than double its incidence (from approximately 6.8 percent of Gdp to 15-16 in 2050). In the mid-long term, the dynamics of the two items will create two different problems: for pensions a problem of social

sustainability, if the employment rates fail to close the gaps with respect to the Eu Partners, working life will not be lengthened and the private pillar will not manage to integrate sufficiently; while for health care a real and true financial problem, that is unbearable pressure on the public budget.
The development of the private pillar would also bring positive effects in terms of incentives to work, productivity, and the lengthening of active life, from the moment that, boosted by tax relief, the single adherent's savings would accumulate to his advantage only, with his rights to the fruits thereof guaranteed. From this point of view, the private pillar in health care would reinforce the virtuous properties of the rules of notional capitalisation calculation introduced by the "Dini" pensions reform of 1995.

3. A Proposal: Open Capitalisation Funds for Welfare

In order to promote the development of a financing channel based on real accumulation, it would be useful to reflect on the possibility of a convergence of the two complementary coverage: the pension one and that for health care, for both acute and long term care provisions.
This is a subject that concerns primarily the funds rather than insurance plans, because the formers have, through simplification, standardisation and critical mass, higher potentialities of lowering administrative and managing costs.
By combining pension and health care aims, it would be possible to borrow the actual pension funds structure directly, for then completing and perfecting it. More specifically, the three goals - pensions, acute health care and long term care - could refer to the same legal subject, identifiable as <*open capitalisation welfare fund*>, operating through the real accumulation of contributions on members' individual accounts, and linked to collective insurance coverage against major health risks and lack of self-sufficiency.
Incidentally, the current Italian legislation already allows pension funds to pursue aims of a health/socio-health nature by disinvesting a predefined percentage of accumulated capital, or by using a percentage of member's contributions to buy an insurance coverage against major critical events, and in particular the lack of self-sufficiency.

4. The Possible Advantages of Open Capitalisation Funds for Welfare

Several advantages can be derived from the introduction of open capitalisation welfare funds:

1. Homogenization of tax treatment would produce transparency and effectiveness for fiscal incentives, which today are different for pension and health care funds. It would be possible to concentrate on the tax detraction scheme that, as the Oecd suggests, is capable of attracting wider groups of workers, while favouring a better control of tax expenditure;

2. Today, both health and pension funds compete for the same financial resources: the contributions of employees and of sponsor companies, the contributions from members independently of their work situation, and the severance pay. Open welfare funds would channel these resources into a single accumulation programme;

3. The open welfare fund would open up possibilities for lowering administration and managing costs, and above all it would make integrated management of financial flows possible, both capable of making the most of the benefits of the capitalisation over mid-long term periods, and of carrying out a broad diversification of risks;

4. With regard to the supply of services, the performance of the various functions could be guaranteed in conditions of greater flexibility, efficiency and effectiveness:

4.1 Parts of the resources accumulated within the fund could be disinvested in the course of a member's working life, within limits and for specific purposes, to enable meeting personal and family health care expenses. In particular, a given amount could be dedicated, year by year, to finance copayments for the access to health care services provided by the public health care system. Resources to finance copayments would be deducted from the accumulation on member's individual account, meaning that copayment schemes would not lose their positive properties of demand and supply regulation (see following point 4.8)[1];

4.2 For acute health treatments which involve high costs (either because they are not provided by the public sector or because accompanied by high copayments), as well as for socio-health cares (first of all, the lack of self-sufficiency), it would be possible to buy, as a particular asset of the fund, a collective insurance coverage for all members, paying premiums by disinvesting, year by year, a part of the capital accumulated in the individual accounts[2]. It is necessary to apply pure insurance coverage only to a limited group of treatments, because this kind of coverage is not equipped to deal with the dynamics of future expenses. As the difficulties American insurance companies are experiencing demonstrate, the pure insurance coverage ends up with the recurrence, in the private area, of the same defects as the pay-as-you-go in the public health care systems. Insurance pooling is not but a pay-as-you-go scheme applied over the group of insured members;

4.3 Using a portion of the capital accumulated at the moment of retirement, the fund may buy a collective insurance coverage against the risk of lack of self-sufficiency for the whole period of the members' retirement;

[1] This point is of great importance in the light of the moving from the absolute toward the selective universalism.
[2] Minor health care expenses can be directly financed using resources withdrawn from the accumulation. For bigger expenses (such as for lack of self-sufficiency), it is essential to maintain a pure insurance coverage, so as not to over weaken the accumulation program. This is the rationale for the link between the open fund, based on the accumulation of individual contributions on individual accounts, and the acquisition of collective insurances as part of the assets of the fund.

4.4 Since one of the aspects considered less satisfactory for pension funds (at least in current Italian legislation) is the rigidity of the subdivision of accumulated resources between an annuity and an una tantum capital, it would be possible to allow a wider access to una tantum to members who, by adhering to the collective insurance cover against lack of self-sufficiency, already pursue part of the insurance finality associated with the constitution of an annuity;

4.5 Collective insurance contracts would have the advantages of lowering individual negotiation costs for members, and of facilitating risk exposure management on the part of insurance companies;

4.6 Collective insurance contracts, moreover, would reduce the distortion caused by adverse selection on the part of members (those most exposed to adverse events tend more often to nee health treatments), and the distortion by excess of screaming by insurance companies (coverage is preferably offered to those less at risk). In some cases, this distortion may even mean that the company refuses to insure;

4.7 These virtuous effects, described in the two preceding paragraphs, would be enhanced if the fund, though maintaining voluntary membership, had a legal obligation to subscribe a collective insurance coverage for the risk of lack of self-sufficiency of all its members (a sort of condition to obtain tax benefits). In this case, the risk to incur in an adverse event would be spread over a much larger group of persons of different ages (all those who in the meantime are contributing to the complementary pension);

4.8 Finally, with the open fund the member would have a greater sense of responsibility toward the disinvesting of resources from the fund to finance the access to health care provisions. In fact, those resources would continue to accumulate within the individual capitalisation account, creating future pension benefits. The full appropriability of the resources, accrued on the personal account, reduces the likelihood of opportunistic behaviours of moral hazard;

5. The open nature of the fund would not impede the allowance, besides the individual adhesions, of collective adhesions by whole groups (employees of a company, workers of a sector, of a territory ...). Together with the complete portability of individual positions (even in the case of collective adhesion), the open nature of the funds can work as a constant stimulus for transparency and cost efficiency;

6. Another advantage can be added to those listed. Within an appropriate normative and regulatory framework, the open welfare funds would have the right characteristics for carrying out the function of choosing the best health care, and channelling the demand of their members towards them, whether public or private. A mechanism which, supported by detailed and certified information on funds performance and of the suppliers that the funds choose, could promote not only cost efficiency, but also quality in services. Moreover putting public and private suppliers in positive competition could contribute to reset that border between the political and the health care organisation spheres in Italy, that is all too often a very grey are often a too grey area.

5. Conclusions

A new tool, such as the one suggested in this position paper, certainly requires a detailed plan and also an innovative effort on the part of financial managers and insurance companies.

Nevertheless, the convergence of pension and health funds can open important possibilities for the reform of the financing structure of the two major items of welfare expenditure. It could bring about the decisive impulse for the development of a complementary private pillar based on the real accumulation of contributions on the markets, and integrated with collective insurance coverage for those health expenditures which, by their very nature, cannot be financed only by the accumulation of resources in individual accounts, but need to rely solely on a pure insurance scheme.

Open welfare funds would have the merit of rebalancing the pay-as-you-go scheme on which most welfare systems today rely. Moreover, through the more suitable combination of tax incentives and collective insurance coverage for major health expenses, the development of open welfare funds would not contrast with but, on the contrary, reinforce those principles of solidarity and cohesion which are at the grounds of welfare systems. And this is especially true in the presence of ageing populations and rising incidences of health care expenditures over Gdp.

The proposal for open welfare funds deserves to be closely examined technically, socially and politically.