COMMENTS ON SESSION 3
HEALTH CARE AND LONG-TERM CARE

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1 Introduction

The two papers which are the subject of this comment nicely complement each other: both deal with demographic pressures and their effect on public finances – one paper arguing from a national perspective, focusing on health care as a specific policy field affected by demographic changes; the other one assuming a global perspective, considering aging costs in general and their impact on national public finances also in a global context, by taking into account international spill-overs.

2 Discussion of "The Health Care System and its Fiscal Impact in Colombia" by Sergio Clavijo and Camila Torrente

The topic of the paper is the determination of the contingent liabilities of the Columbian health care sector for the period 2007 to 2050, which is undertaken in two steps. In a first step, the public health care deficits for the period 2007 to 2050 are established. Hereby, the baseline scenario is characterised by an increase of the contributors/employed ratio from 40 to 50 per cent by 2050 and an increase of coverage from 86 per cent to universal coverage by 2012. In a second step, the net present value of health care contingent liabalities is calculated for the period 2007 to 2050. In 2007 the net present value of gross public obligations (i.e. public spending) amounts to 110 per cent of GDP for the baseline scenario; when taking into account the revenues, the net present value of net public obligations reaches 97 per cent of GDP.

The issue at hand is a very policy-relevant one. One of the most important tasks policy-makers are facing today is ensuring the long-term sustainability of public finances in general and of social security systems in particular. One dimension of fiscal sustainability – short-term fiscal sustainability – are the current liabilities of social security systems, *i.e.* current "explicit" net expenditures and the current deficit. Another dimension of fiscal sustainability is long-term fiscal sustainability: this is about contingent liabilities, *i.e.* "implicit" liabilities (discounted future net expenditures) assuming unchanged policies/legislation. This second dimension is important for tax-payers (also from a democratic point of view) as well as for policy-makers, who should take into account also long-term fiscal sustainability when deciding about fiscal policy measures and the design of social security systems.

In developing and emerging countries ensuring long-term fiscal sustainability of social security system is a particular challenge, as these in many cases only exist in a rather rudimentary form and have to be expanded in the future. On the one hand, this requires considerable public funds. On the other hand this offers chances, too, as policy-makers are not confronted with a historically grown system where reforms are hard to implement against the resistance of strong lobby groups defending their vested interests, as is mostly the case in the industrialised countries with their extensive welfare states.

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The fiscal position of the health care sector is influenced by several factors, some of which can be directly influenced by policy-makers (these are written in bold characters in the following), and which can be grouped into revenue-related and expenditure-related factors.

With regard to revenue-related factors, it must be distinguished between contribution-based and tax-financed systems. Contribution-based systems are affected by the labour market situation (participation ratio, unemployment ratio); by statutory contribution rates and the definition of the base for contributions (wages, value added, capital incomes, exceptions, etc.); by statutory coverage (persons liable for contributions, also in a household context; employers) and *de facto* coverage (which is influenced by the size of the informal sector and the contributor/employment ratio); and finally by the development of the contribution base (wage growth, etc.). Tax-financed systems depend on the short-term volatility and the long-term elasticity of the overall tax base and thus overall tax revenues and on discretionary changes of single taxes.

Expenditure-related factors comprise demographic factors (population growth, aging, life expenctancy, fertility, epidemiological profile); the technological development; income (as health care is a normal good for which demand raises with income) and institutional factors (deductibles, eligibility criteria, coverage).

The results of the calculation of contingent liabilities crucially depend on the assumptions about the most important factors influencing revenues and expenditures of health care systems. The study takes into account selected factors affecting the fiscal position of health care systems only: the contributors/employed ratio on the revenue side, and population growth and coverage on the expenditure side. Two very relevant factors with countervailing effects are neglected: the labor market situation (*i.e.* the participation ratio, for which the development of female employment and the transition from self-employment to dependent employment should be of particular importance, and the unemployment ratio) as well as the technological development and income growth as cost/expenditure drivers.

Crucial are furthermore the assumptions about the development of the factors considered; which raises the question how reliable the projections used are, and how sensitive the results are with regard to the underlying assumptions. Therefore an extended sensitivity analysis – in addition to the sensitivity analysis the authors conduct for the development of labour formality – may be useful.

I would like to close the comment on this paper with some policy implications and recommendations, respectively.

Firstly, on the revenue side the financing system itself is of relevance, *i.e.* whether the social security/health care system is contribution-based or tax-financed: see the debate in many industrialised countries, particularly in those with contribution-based Bismarckian systems, about the high and increasing tax burden on labour (for which Austria and Germany are striking examples). Moreover – and this is specifically relevant for developing/emerging countries – one advantage of a tax-financed system is that it is less sensitive with regard to the size of the informal sector, and that it does not have negative feedback effects on formal employment, whereas contributions contain incentives for employees to remain in or to change into the informal sector and for firms to employ unofficial workers to avoid the payment of social security contributions.

Secondly, the financial situation of the health care system theoretically could be improved by revenue-related and expenditure-related measures.

Revenues could be increased by:

- extending coverage via measures to increase labour market participation (e.g. to increase female employment by policies to reconcile family life and work) and to increase the contributors/employed ratio by inducing a transition from the informal to the formal sector (e.g. by intensifying control measures and sanctions),
- eliminating exceptions with regard to the contribution base and to the persons/firms liable for contributions,
- broadening the base for contributions through, e.g., a move from wage to value added,
- increasing overall tax revenues (which of course depends on the existing room for manoeuvre to increase the total tax burden).

To contain expenditures, possible approaches could be:

- restricting access to health care services (e.g. by providing only "necessary" services free of charge – which of course raises the question how to distinguish between necessary and non-necessary services),
- increasing private co-financing of services via deductibles (whereby the distributional consequences are to be considered),
- decreasing waste by a more efficient organization of the health care sector.

3 Discussion of "Global Aging Pressures: Impact of Fiscal Adjustment, Policy Cooperation, and Structural Reforms" by Dennis Botman and Manmohan Kumar

The paper sets out to determine the macroeconomic impact of alternative options for fiscal adjustment and structural reforms to cope with global aging pressures. This is done from an international/global perspective, including four countries/regions (Germany, the US, the rest of the Euro area, and the rest of the world), and using the IMF Global Fiscal Model (GFM).

The GFM appears to be an adequate framework to deal with the issues treated in the paper. Firstly, the model depicts the structure of public expenditures and revenues (tax systems) in great detail and thus allows the analysis of the macroeconomic impact of a rather extensive catalogue of reform measures. Secondly, the model considers the interdependence between countries/regions via goods and capital markets. This is an essential feature because questions of aging cannot be treated isolatedly from the international context in a globalised world.

As the example of Germany shows, these interdependencies assume an impressive magnitude. By 2040, the projected debt level due to aging in Germany alone will reach 160 per cent of GDP, while the projected debt level due to aging in Germany, the US, and the rest of the Euro area will amount to 370 per cent of GDP in Germany: which is well above the projected level for the scenario that ignores international spill-over effects of aging. Against this backdrop the authors argue for an internationally coordinated approach to tackle aging pressures.

I would like to make a few remarks:

- firstly, the assumption of perfect capital mobility appears to be rather strong and may lead to an overestimation on international interdependencies and thus of the benefits of international cooperation,
- secondly, the results of the country-specific/region-specific demographic costs crucially depend on the underlying long-term assumptions and projections (with respect to demography, economic development, labour market developments), which raises the question again how reliable the results are and how sensitive the results are to variations in the underlying projections and assumptions. To illustrate this at the case of Germany again: the projected debt

dynamics show considerable sensitivity with respect to the different cost scenarios. For a medium/baseline cost scenario of an aging cost increase by 4 per cent of GDP by 2050, a debt level of 170 per cent of GDP can be expected, while the debt level is projected at 120 per cent (290 per cent) of GDP for a low cost (high cost) scenario with an increase of aging costs by 2.75 per cent (7.75 per cent) of GDP by 2050. Thus, policy-makers are confronted with a high degree of uncertainty concerning the adequate size and timing of the implementation of fiscal adjustment measures,

- thirdly, the case for international cooperation is convincingly made by the authors. However, several caveats should be considered:
  - as populations age at different rates (depending on birth rates, mortality rates, migration), the pressure to implement fiscal adjustment measures and to join coordinated action may differ across countries. Moreover, countries facing high aging pressures and trading partners with comparatively low/delayed aging pressures may have little incentive to take part in joint action.
  - regarding country-specific differences in the general socio-economic conditions and public finance structures, it is questionable whether joint action based on identical/similar fiscal adjustment packages is appropriate. A "one-size-fits-all approach" may not be accepted by countries with differing socio-economic conditions; in this respect, also differing degrees of openness and differences in country size may be of importance. The same holds for structural reform strategies: the question is whether the "Lisbon agenda" may serve as a useful agenda for the rest of the world outside Europe.

Let me finish with some questions for future research:

- what is the optimal design of tax systems for an aging society, which may be characterised by changing consumption patterns or a shrinking base of direct taxes due to decreasing labour incomes?
- what are optimal fiscal adjustment strategies to aging pressures and optimal structural reforms for industrialised versus emerging/developing countries?
- how could incentives and an institutional framework for international cooperation, for coordinated efforts to cope with global aging be designed?
- the role of international migration should be considered: it may ease demographic pressure in the receiving countries and exacerbate them in the sending countries and thus shift aging costs between countries. Maybe it would be useful to integrate international migration into the GFM as an additional channel of spill-over effects of aging.
- the role of structural reforms within social security systems should be given more thought (see the debate about capital-funded versus pay as you go (PAYG) systems; or the discussion on contribution-based versus tax-financed systems). Particularly a transition from a PAYG system to a capital-funded system as realised or at least debated in a number of countries can be expected to have considerable international spill-over effects.