

The High Price of Living Longer: Pay-as-you-go or No Frills Aged Care?

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With the insurance industry facing market failure over its inability to provide ageing and longevity products, a government insurance scheme catering to the health and care needs of Australia's ageing population may prove a viable option. It's just one of the suggestions to emerge in the wake of the Productivity Commission report, [Caring for Older Australians](#), which highlighted a series of possible discomforts for Australians as they live increasingly longer, including a user-pays system for better quality care. Drawing down on that cherished asset, the family home, is another important adjustment that must be faced, insists [Michael Sherris](#), an actuarial professor at the Australian School of Business, and the sooner Australians realise that the better. In a wide-ranging interview with Julian Lorkin of Knowledge@Australian School of Business, Sherris explores some of the controversial key points raised by the commission's report.



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An edited transcript of the interview follows.

Knowledge@Australian School of Business: The Productivity Commission has found the need for a user-pays system that's means tested, so those with the highest means will pay more. It's controversial among the affluent, but is it fair?

Michael Sherris: This is the major issue facing not only Australia, but other developed economies. Financing the costs of care as we get older needs to be done in a way that reflects the means we have to fund our own healthcare and also the contribution the community can afford to make. This is why you have to have a system where there's a public and private contribution. Obviously those with higher means can afford better services, perhaps beyond what would be given in a basic service to everybody. And that's the nature of this Productivity Commission recommendation.

Knowledge@Australian School of Business: Let's split it up into healthcare, everyday living expenses and accommodation. Starting off with health, the Productivity Commission suggests that certain aspects of aged care, similar to medical care, should be spread across the population and the rest should be a private responsibility. What's going to be the impact of this?

Michael Sherris: There are obviously some healthcare services that are essential and required and there are other healthcare services that are more expensive and maybe more specialised, so to distinguish between those two in terms of financing is one way to go. It's really a question of deciding how much healthcare can be provided to everybody on an affordable basis and how much in terms of more advanced techniques and more advanced drugs, for example, can be provided at individuals' own expense rather than shared across the community.

Knowledge@Australian School of Business: But isn't there a risk that if the government pays for some part of healthcare then the costs are going to carry on escalating in the way they have done over the past 50 years?

Michael Sherris: That's right. Healthcare services are becoming much more expensive as they've become more sophisticated, so there has to be some limit to what the government and the community can provide. There has to be a line drawn in the sand, and setting up a basis where there's a basic level of care that you can expect and get provided and then [a level] beyond, where you provide your own resources, is a sensible way to go. In the UK, they've just had a similar review and made similar recommendations, in

terms of [allocating] an amount that can come from the community and then costs coming from individuals beyond that.

Knowledge@Australian School of Business: In the UK, this was regarded as highly controversial. For some conditions, such as a broken leg, care may not be too expensive, but what about cancer? What happens if the state only pays for a certain limit on care for a disease that may require ongoing care for an older person?

Michael Sherris: This is going to be the real issue. At the moment we don't have an insurance market for long-term care or care in general and it is really expensive. When you start actually costing it – and that's what this system is going to force people to do – they will realise what level of care they can actually gain and whether they're prepared to fund that through either their own savings or through some insurance arrangement.

Then, as we've seen, the cost is going to increase and the government has to put some limit on it from a budgetary point of view – it has to make a decision about what level of care it can provide and what level of care has to be provided from our own resources. And that puts pressure on our own savings. (In the big picture,) it also calls for a more careful look at how insurance markets may be able to help fund this.

Knowledge@Australian School of Business: The insurance companies don't seem keen to come up with products designed for the elderly to pay for those extremely expensive items that people get in their later years.

Michael Sherris: That's right. Long-term care insurance isn't really provided and the Productivity Commission said it's not going to be provided. It's basically a market failure and we see this in many different areas around insurance for ageing and longevity. This really means finding a way to somehow cap the costs to provide an affordable insurance product.

The concept of insurance and pooling risk can be a valuable one because it means that some people may not be exposed to the very, very high costs and it may be only a relatively small proportion of people who are, but we all may face that risk and it may be in our benefit to have an insurance arrangement where these catastrophe costs would be funded from an insurance pool. The government does that with its tax system, but it isn't set up as a formal insurance system.

It also could benefit Australia to look at trying to set up a government insurance-based scheme, which would substitute for the private markets that don't seem to be able to handle these types of products very well.

Knowledge@Australian School of Business: The Productivity Commission looked at living expenses. The compulsory superannuation scheme is very successful at getting people to save, but many people just run out of money because it's such a tiny proportion taken out annually. The Productivity Commission didn't seem to come up with many alternatives to this problem.

Michael Sherris: There's a challenge in how you convert people's savings for retirement into an appropriate income stream. And, when you start thinking about healthcare costs and healthcare risks, it becomes even more complex. The standard annuity products provide a regular income but they don't insure against these one-off health impacts. If you become so ill that you have to move into a nursing home or you require very expensive care, the standard annuity product with an income stream doesn't cover those risks.

There have been some proposals about including more flexible annuity arrangements, where it's possible to draw income out of the annuity in the event that these events happen. That's really tying together long-term care insurance with income insurance, like an annuity. But these markets don't work. We've seen it around the world; we see it in Australia. They generally have fairly high costs, which mean the benefit of insurance and insurance pooling are withered away by the costs of running these schemes.

People are left with self-insurance and that amounts to saving money and having enough money – in other words, being very precautionary in how you use your savings – so that if you need care and there's a high expense, you can somehow draw on your own savings. In Australia, we rely very much on our house to do that.

Knowledge@Australian School of Business: The Productivity Commission looked at that option. Another option outlined in the report was to allow pensioners to sell their house, deposit the money in a government-backed aged pensioner saving account and yet still receive a pension.

Michael Sherris: In Australia, with a means test for the pension, the house gets special treatment. If it's your residential house, it's not included in the assets test. Most Australians have a very high proportion of their wealth in their house, particularly those retiring now. Maybe 60% of their wealth on average might be in their residential house.

It's a very important asset. It provides a very valuable benefit in terms of saving them paying rent and it also gives them the comfort of their own home. It has the potential to be an asset that they can leave to their children.

But it also has this precautionary savings component where if you really need to draw on assets beyond your retirement income to cover these health shocks, it can potentially do that. Particularly if you're going to be moving out of your house into a nursing home and you want to finance that move, then obviously one way is to unlock that equity in your house. It acts as an insurance mechanism, a precautionary savings mechanism. And that's why ways of unlocking that equity in a flexible way are valuable for individuals.

One of the ways we do it is through the private reverse mortgage market. Now the government is stepping in and providing effectively a reverse mortgage market and also providing the ability of individuals to maintain their means-tested benefit for their housing assets by putting it into a special account.

Knowledge@Australian School of Business: Will this mean that people will have to change their mindset in Australia? People try very hard to pay off their mortgage before they retire and then hand the house on to their children. Now maybe they're not going to be able to do that.

Michael Sherris: The sooner people realise that the better. When we look at funding retirement we have our superannuation savings and we've been accumulating that over some years now and people are getting to the stage where they have reasonable amounts of assets, and that's going to grow. But still a very substantial component of their savings has been their house. When they look forward and see that they're going to be living for much, much longer than they thought they were ... for example, when they reach age 65 that they could be living to 95 or 100. They don't really think about that. And in those older ages, they are going to need much more care; more services around health and they also have to think about their living arrangements and what sort of support and care they're going to get. Children don't necessarily provide that as maybe they have done historically.

We need to think about that more carefully and that means we need to look at our total asset position, not only our savings for retirement in superannuation, but housing and private savings. We have to think about how we can fund these risks and we have to understand what these risks are. A lot of people don't really understand the actual costs that are involved if you are living beyond a certain age if a bad health outcome occurs and how to finance that.

Knowledge@Australian School of Business: There will be living expenses just for accommodation for those extra years. And it may be that they will be in aged care at the same time as their children! The government seems to be looking at more intervention to encourage us to work out how we're going to be able to afford that, but should the government be looking after that?

Michael Sherris: It's a very tricky issue. Most individuals would want to stay in their home as long as they can. Because of the drugs that we have and other treatments, we are seeing the ability for people to live in their own homes unassisted for longer. Perhaps it's only towards the end of life when they get really ill that they might be moving into an aged-care facility where they need that higher level of care.

[The costs] may be quite extreme for a smaller group of individuals, particularly those living right into the very older ages. These days, people can be living quite well on their own or as a couple in a house in their 70s, or even at 85. We need to think carefully about when these impacts are likely to occur, and generally it's going to be at much older ages. We'll be staying in our own home as long as we can with assisted care where the cost of care is not as high as when we move into that aged-care facility for a much higher level of care towards the end of our lives.

Knowledge@Australian School of Business: Is there any way of reducing the cost of aged care? Many aged-care homes now are in converted properties, which require a lot of maintenance and staff. There's been a suggestion that we ought to have these warehouse-like aged-care homes, like dormitories. It's not an attractive proposition, but it would be much cheaper.

Michael Sherris: This is where individuals' own resources and savings come into the picture. It's also the reason why many people do prefer to stay in their own home as long as they can. When they become widowed or a partner dies, they still want to stay in their own homes. They don't like to move into retirement home facilities. Some will, but in terms of aged care where you need this intensive care, that becomes a different issue and you have to finance that. Obviously, it's going to be a situation where the community can afford a basic level and then, beyond that, you will need the resources – and one of the ways you can unlock resources is through your house. That's the issue that still has to be addressed.

Knowledge@Australian School of Business: The Productivity Commission looked at another issue in terms of the number of people that will have to look after the elderly. The report says we need to attract more workers into the industry – the industry can't cope with the number of people working in it at the moment. How can you encourage people to work in this industry?

Michael Sherris: This is a huge issue because in order to attract people you need to have specialist training in this area and salaries that are attractive to people in terms of meeting those costs. Australia isn't a low-salary environment. In some countries, you can have people from other countries – such as the Philippines – coming in and acting as carers and the cost is not as high as it would otherwise be.

But in Australia we have to face that it's going to be a much more expensive proposition and to attract people – I'm sure the resources are there – there's going to be a cost. We're going to have to fund that cost, otherwise we'll be in a situation where we're not going to get the service we want. Even if we say the government has to provide it, if it can't provide it at a particular cost, it won't happen.

Knowledge@Australian School of Business: For those looking at having to re-mortgage their house to finance living for longer, moving to a much cheaper country may look like a more attractive option. A very small number of people have gone off to Bali, Thailand and other parts of Asia, where they can live very cheaply and get cheap care to look after them. Is this likely to become a trend?

Michael Sherris: This is something that probably hasn't been given a lot of consideration but it may start becoming more important. We're in a relatively lucky country in Australia at the moment. We haven't been impacted by the global financial crisis, we're not in recessionary conditions. We don't have a social security system that's underfunded, like many European states, for example. A lot of people actually want to come to Australia, so we're in a position where younger people are coming as migrants, particularly to work in the booming parts of the economy.

Down the track that may not be the case and people may decide that Australia is becoming too expensive to stay here and look at cheaper alternatives. Then that's quite a major move. It may be an easier move to sell your house and fund yourself into a reasonable retirement facility here in Australia, rather than moving to another country, particularly at an older age.

Knowledge@Australian School of Business: Mike, we've got all of these recommendations from the Productivity Commission, and the government last year released the [Henry] review into Australia's Future Taxation System, from which few recommendations have been implemented so far. The government says it's looking very seriously at these proposals from the Productivity Commission, but how many do you think will be implemented?

Michael Sherris: This is the challenging question. Through the Henry tax review there were a very limited number of proposals implemented or proposed to be implemented from that. And the government is facing a lot of issues at the moment, particularly around carbon tax and a whole bunch of other issues.

The Productivity Commission report – even though it's been very important and the government has indicated it's an important matter – will probably follow the Henry review on to the backburner, as something that they may address more in the longer-term. But these issues are things that really need to be addressed now. However, when you have political parties struggling with their majority and how

they're going to stand in the next election, sometimes issues like this don't get the weight they deserve.

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