THE HOME CARE RESEARCH INITIATIVE: A PROGRAM OF THE ROBERT WOOD JOHNSON FOUNDATION

POLICY BRIEF

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Funding Long-Term Care by Applying the Trade-Off Principle to Public and Private Insurance

The uncertain need for long-term care (LTC) services is a risk that is best protected by insurance. However, current LTC funding in the United States relies heavily on personal payment and public welfare and only lightly on social insurance and private insurance. This method is akin to sitting on a two-legged stool, which is likely to be unstable. This brief describes a "three-legged" funding model where social insurance would provide basic LTC protection that would be supplemented by private insurance and personal payment. The model would mobilize public and private resources more effectively by linking LTC insurance to social security, private life insurance, and other financial products.

Aging and the Risk for Long-Term Care

In the coming decades the greatest challenge for LTC will be the aging of the population. The number of elderly Americans will rise rapidly as the Baby Boom generation – those born from 1946 to 1964 – reaches retirement age. In 2000, 4.3 million Americans were age 85 and older. This number is estimated to rise to 6.8 million by 2020, and to 14.3 million by 2040.

The likelihood of receiving LTC services increases dramatically with age. In fact, over 50 percent of people aged 85 and older receive such services, either in community settings or in nursing homes, compared to only 12 percent of persons aged 65 to 84.[1]

The challenge then to both society and individuals will be to finance the LTC needs of this growing elderly population.

Long-Term Care is an Insurable Risk

The uncertain need for LTC services is a risk that carries with it substantial, even catastrophic financial consequences for individuals, but it actually only occurs to a relatively small and predictable proportion of the total population. Therefore, the most sensible approach is to use insurance mechanisms, which spread risks of financial loss among a large group of people. Pooling risks and group sharing of losses are the essence of this arrangement. Insurance may be used in both the private and public sectors.

[1] Alecxih, L.M.B. (2001). An Overview of the Long-Term Care Insurance Market: Opportunities and Challenges. Hearing of the Committee on Finance, United States Senate, Washington, D.C. And Scanlon, W.J. (2001). Long-term care: Baby boom generation increases challenge of financing needed services (GAO-01-563T). Testimony before the Committee on Finance, U.S. Senate. Washington, DC: General Accounting Office.

Insurance is Not a Major Source of Long-Term Care Dollars in the U.S.

Although LTC is an insurable risk, in practice the U.S. relies very little on insurance to finance necessary LTC services. Of the total formal (paid) LTC expenditures for the elderly, estimated at $123 billion in 2000, less than a third were covered by insurance mechanisms such as Medicare (24%) or private LTC insurance (4%). In contrast, personal out-of-pocket payments and Medicaid – a welfare program – each accounted for 35 percent of expenditures (see Figure 1).

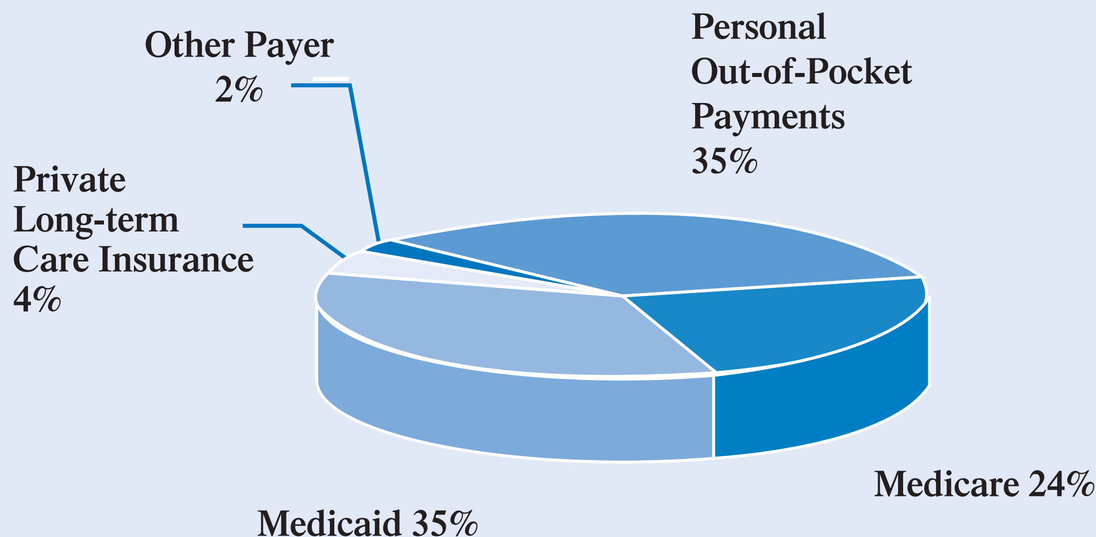
Financing Reform is Needed

Heavy reliance on out-of-pocket payment and public welfare for LTC has spawned many calls for reform over the years. Expanding Medicare to include LTC has been suggested as one option. However, since public resources needed to sustain Medicare and Social Security already pose a major political challenge, calls for more commitment of tax dollars have not been taken seriously.

Private LTC insurance, much touted as a promising source of funding, has not proven widely popular, despite tax incentives at the state and federal levels. Although the number of new policies has risen in recent years, only an estimated 4.1 million people have such coverage.[2]

[2]Scanlon, 2001

FIGURE 1: FORMAL LONG-TERM CARE EXPENDITURE FOR THE ELDERLY, 2000



Source: Congressional Budget Office. 2000. *The Budget and Economic Outlook: An Update.* Washington, D.C.

Ultimately, the debate on reforming how we pay for LTC comes down to the question of how to obtain additional funding. Many now realize that neither the public nor the private sectors have the financial wherewithal to meet the high and growing LTC costs. Policy makers should seek to secure funding from both sectors in order to ensure that LTC services are financed.

A Three-Legged Stool Funding Model

Based on the premise that both public and private resources are needed to fund LTC and that insurance should be a key component of funding, a three-legged stool model is the most sensible option. It would begin with creating a social insurance program that would provide a basic amount of LTC coverage. This program would be supplemented by private LTC insurance and personal payment. When these three sources fail to provide for some individuals, Medicaid would act as the safety net.

The Trade-Off Principle

We could accommodate more expenditure for LTC if we merged some of our resources and allowed some to be traded off for others. For instance, in the public sector, we could fund the social insurance plan for LTC by having retirees contribute a small portion, say 5 percent, of their Social Security or government employee retirement benefit. In return for this small reduction in their take-home benefit, they would receive basic coverage through a Social Security/Long-Term Care Plan (SS/LTC Plan). SS/LTC would exempt low-income beneficiaries from the trade-off.

The trade-off principle could also apply to the private sector. We could encourage people to purchase LTC insurance by linking it to life insurance or annuity products. We could also link it to employer pensions; government employee retirement programs at federal, state, and local levels; individual retirement accounts (IRAs), Keogh plans, and 401(k) plans; and home equity conversion plans, such as reverse mortgages.

Some linking of insurance products with LTC benefits already occurs. Nearly 15 life insurance companies market a life insurance or annuity product with LTC benefits.[3] Some life insurance products now offer LTC coverage with the condition that the final insurance payout upon death will decrease based on LTC expenses incurred during the policyholder's life.

A Social Security/Long-Term Care Plan: Public Receptivity

Would the public support SS/LTC?

A study of opinion polling may be necessary to explore this question in more depth, but two public opinion surveys from the early 1990s are suggestive. In a 1993 survey conducted by the Employee Benefit Research Institute and the Gallup Organization, 65 percent of respondents said they would accept a reduction in employer contributions to a pension plan in return for an increase in health benefits.[4] In a 1992 survey, a majority (53 percent) of non-retired people said they would accept a lower level of Social Security retirement benefits in exchange for higher Medicare benefits.[5] These public reactions to similar trade-offs suggest that many older persons might favor the suggested SS/LTC.

[3]Health Insurance Association of America (2000). Long-Term Care Legislative Chart. Washington, D.C.
[4]Employee Benefit Research Institute (1993). Public Attitudes on Benefit Trade-Offs, 1991: A Summary (Report #G-45). Washington, D.C.
[5]Employee Benefit Research Institute (1992). Public Attitudes on Medicare and Retiree Health (Report #G-38). Washington, D.C.

Questions for Further Study

This brief discusses an SS/LTC plan only on the conceptual level. The implementation of SS/LTC will require answers to many questions, including:

- Who would be eligible for benefits, and what would trigger services?
- What types of services would be covered?
- Would the program be mandatory or voluntary?
- Would it pay benefits regardless of the setting in which the recipient lives/care is provided?
- How would the benefit paid under SS/LTC be coordinated with payment from private LTC policies?

Additional polling would be necessary to better understand public perceptions concerning these issues.

Conclusion

The demand for LTC will increase as the Baby Boomers age in the next few decades. The costs to both individuals and society could be immense. It is unlikely that our society can meet that demand, given the present mix of LTC funding, which primarily relies on out-of-pocket payments and public welfare.

Because insurance is the best way to protect against this type of risk and because neither the public nor private sectors alone have sufficient resources to pay for LTC, policy makers should consider a three-legged stool funding model consisting of a basic public LTC insurance plan, paid for by a portion of retirees' Social Security benefits; private insurance contributions linked to life insurance or annuity products, retirement saving plans, home equity conversions, or the like; and supplemented by private payment. By merging resources from all three "legs of the stool," the trade-off principle can be used to mobilize public and private resources more effectively and to protect our aging population from the catastrophic costs of LTC.

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The Home Care Research Initiative, a program of The Robert Wood Johnson Foundation, was established to support research and analysis that will improve the knowledge base underlying home care policy and practice. It is based at the Center for Home Care Policy and Research at the Visiting Nurse Service of NY.

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