

# **On the Inclusion of Dementia Patients into Compulsory Long-Term Care Insurance – A Sustainable Step?**

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The increasing scope of claims to which dementia patients are entitled to under the German Long-Term Care Insurance (LTCI) has for quite some time been a topic of political debate. A question has arisen about the extent to which additional LTC benefits should be made available to this steadily growing subgroup. However, since the LTCI is already struggling financially to maintain the status quo as it is, the situation would not seem to allow for any further extension of benefits. This has only recently become apparent in the deficit of 820 million Euro in 2004.

The reason for the increasing financial imbalance in LTCI is its method of financing, namely of the pay-as-you-go type, in combination with the demographic changes in Germany in form of an aging population. According to the pay-as-you-go principle the expenditures of each period have to be covered by the revenues. Hence the greater the proportion of the old population in relation to the young working population, the more the working population has to contribute to LTCI to finance those in need of long-term care. This leads to continuously rising contribution rates.

Relaxing the eligibility criteria for the subgroup of dementia patients further aggravates the burden of rising contribution rates for today's young and future generations. Granting additional transfers is financially not feasible without shifting further implicit debt onto future generations. Nevertheless, two reform concepts for LTCI have recently been brought forward. They claim not only to achieve a stabilization of the contribution rate, but at the same time to be able to raise long-term care transfers for dementia patients. One proposal envisages turning LTCI into an insurance for all citizens, the so called citizens' insurance or *Bürgerversicherung*, thereby extending the pay-as-you-go principle. The second reform proposal intends to reduce the pay-as-you-go financed part of LTCI, while simultaneously building up a funded supplementary insurance. This paper seeks to analyze whether either proposal is in fact able to achieve sustainability in LTCI.

Before starting our analysis of financial sustainability, we need first to forecast the number of future dementia patients. This will, in a second step, enable us to provide an estimate of the effects the additional grants have on the development of long-term care

expenditures. According to the age-specific prevalence rates (based on field studies by Bickel (2000)) and the 5<sup>th</sup> variant of the 10<sup>th</sup> coordinated population projection of the Federal Statistical Office, the number of dementia patients can be extrapolated for all years after 2003. Compared to “all other beneficiaries” of long-term care, this projection reveals that the number of dementia patients will rise disproportionately fast.<sup>1</sup> While the number of all the other beneficiaries will double by the year 2050, the subgroup of dementia patients will increase by almost 250 percent. Hence, additional LTC expenditures will be inevitable in any event.

To which extent the expenditures will rise, and how this affects sustainability or rather stabilization of the contribution rate can be demonstrated by using the method of generational accounting.<sup>2</sup> In the isolated case considered here this method is based on the intertemporal LTC budget constraint, capturing all present and future payment and transfer flows between an individual and the LTCI. The net contributions resulting herefrom, the so called generational accounts, are weighted with the cohort size and used to calculate the sustainability gap. The sustainability gap thus identifies the deficit in the intertemporal LTCI budget constraint arising from continuation of current LTC policy. It measures the present value of prospective revenues that are lacking to cover the present value of implicit LTC spending commitments.

Computing the sustainability gap for the status quo of LTCI yields a value of 32,1 percent of Germany's GDP 2003. In absolute terms, this is equivalent to 0,7 trillion Euro. Taking into account the more generous grants for dementia patients, the sustainability gap increases by another 12 percentage points to 44,4 percent of GDP. Implicit debt would rise by 0,3 trillion Euro. Since LTCI is subject to its annual budget constraint (i.e. revenues must cover all expenditures) the contribution rate has to be adjusted accordingly. This results in a rise of the contribution rate from 1,7 percent in 2003 to over 4,5 percent in the year 2050.

In contrast to the development outlined above, the reform option *Bürgerversicherung*, put forth by Karl Lauterbach and Andrea Nahles,<sup>3</sup> claims to be able to stabilize the contribution rate while at the same time broadening entitlements of dementia patients. This is allegedly possible via three elements: First by compulsorily including all citizens in the pay-as-you-go scheme. Secondly, by increasing the assessment limit from 3.525 Euro to 5.200 Euro. Thirdly, by increasing the assessment of contributions through including incomes other

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<sup>1</sup> By “all other beneficiaries” we refer to the subgroup of long-term care patients with physical as opposed to demential disabilities.

<sup>2</sup> This method was developed by Auerbach, Gokhale and Kotlikoff (1991), (1992), (1994) at the beginning of the 1990's.

<sup>3</sup> See Frankfurter Allgemeine Zeitung of March 3<sup>rd</sup>, 2005.

than wages (e.g. interest income). Obviously, all these elements generate higher revenues. On the other hand, if all citizens are turned into prospective beneficiaries, additional expenditures will inevitably follow. Computing the sustainability gap under this reform proposal reveals a rise in the sustainability gap by almost 17 percentage points, namely from the status quo of 32,1 to 48,9 percent of GDP. From these results it should be clear that the reform option *Bürgerversicherung* is far from being able to stabilize the contribution rate. The contribution rate even exceeds the development projection for maintaining the status quo.

Obviously, the concept of broadening the pay-as-you-go principle does not serve to solve the financial imbalance of LTCI. The second reform option, put forth by the Bavarian Secretary for Social Affairs, Christa Stewens, which moves over to a funding strategy might be better suited to stabilizing the contribution rate.<sup>4</sup> This concept envisages freezing the nominal transfer level of the pay-as-you-go LTCI and establishing a supplementary funded LTCI at the same time. This supplementary insurance is supposed to cover the loss in benefits due to the freezing in the nominal transfer level, thus ensuring that the real term transfer level of the base year is always reached. Although this partial funding strategy is potentially a method of resolution to the status quo problem, it nevertheless fails to keep the contribution rate on a constant level of 1,7 percent. It furthermore underestimates the premium needed for the supplementary insurance. Instead of a premium of 4 Euro per month and person and an annual adjustment of 0,47 Euro, 8,50 Euro as well as an adjustment of 1,70 Euro per annum are needed. Similarly to the case of the *Bürgerversicherung* this reform option simply underestimates the additional expenditure effects caused by more generous transfers, especially in the middle- and long-run.

Neither of the reform options considered here can curtail the problems of the LTCI under the conditions of demographic development. While the *Bürgerversicherung* aggravates the demographic burden by extending the pay-as-you-go principle, the partial funding strategy is more in line with a sustainable solution. Yet it does not fully account for the development in expenditures, underestimating the drastic reform measures actually needed. Without having solved existing problems, i.e. the financial imbalance of the status quo, no additional benefits and no new basis for claim should be created. To do so would aggravate the burden for future generations and hamper further reforms.

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<sup>4</sup> See Press Release of the Bavarian Ministry for Social Affairs of December 8<sup>th</sup>, 2004.

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