The future of long-term care [1]

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The government is tilting at windmills with its plans to finance long-term care, says Terry Arthur. Normal market mechanisms could provide everything that people want, if the government would only allow the market to be free and remove the welfare state from people's lives.

Introduction

As the encroachment of government grows larger and larger, so does corruption, greed, and dictatorial behaviour grow likewise. The dumbing down of state education ensures that ?we the people? will become less and less knowledgeable about what is a proper role for government.

A case in point is the issue of Long Term Care (LTC) ? a crisis which has been building up for decades, at the same time as we the people have come to expect a growing NHS and, in many cases, would now expect the NHS to expand as necessary to cover long term care of the elderly. Nor have governments done anything to abuse us of that impossible notion any more than has the NHS which, on the contrary, has encouraged it and advertised ?NHS continuing health care? as ?a package of continuing care provided outside hospital, arranged and funded solely by the NHS, for people with on-going healthcare needs?.

Governments don?t do long term. Few readers may recall that way back in 1997 LTC funding was made a priority by the Labour government, with a Royal Commission reporting in 1999 ? at which point it was thrown into the long grass. Pension schemes (similar in many respects to LTC) have been peppered with reams of rules and regulations throughout my long career in that industry and get worse by the day. The 1997 raid on occupational schemes by Gordon Brown via changing the ACT tax rules virtually killed off final salary-related schemes in the private sector. This raid was upon existing assets, which were backing promises in respect of years of service already accrued, so naturally it plunged many thousands of schemes, large and small, into insolvency. *(1, see references below)* This is a crucial matter because pensions and LTC have many similar features. It is all too easy to see that another ?Brownian raid? may hit LTC providers retrospectively.

In the short run, governments can and do divert resources for anything that may bring votes. The money which Brown threw at the NHS over the last decade like confetti is frightening, yet it did nothing to improve matters at all. Far from it; the MRSA and Clostridium Difficile fiascos were not seen in private hospitals and the scandalous treatment of the elderly in 2009 in many NHS hospitals are just two recent problems in the NHS.

So it is not surprising that when LTC reached the government?s radar screen again a year ago, its reaction was to appoint the economist Andrew Dilnot to prepare a report on ?Social Care?. At least Dilnot had the sense to recognise the weasel word ?Social? and actually reported on ?Care Funding?; unfortunately this assumes all the other issues away!

Despite this, and despite a year in the making, the report released on 4th July, is hardly revolutionary. Essentially it recommends that the current means-tested threshold, above which people are liable for their full care costs, should be raised from £23,250 to £100,000. There would also be a total cost ?cap? after which individuals would pay only food and accommodation costs (say £7,000 - £10,000 pa). The cap would be a once-and-for-all capital amount of some £35,000, after which the taxpayer stumps up the rest ? estimated to reach at least £200 pa per household in the next few years ? another significant ratcheting up of the welfare state.

Insurance

Given the major role of insurance in occupational pension schemes and annuities, insurance would seem to be a natural way to finance LTC. In fact Dilnot does see a role here but he argues that it will always be a limited one, citing difficulty in pricing (the time period is long and the risks uncertain; a lack of understanding; a belief that care is free like the NHS; a preference for individuals to take a risk rather than an unpredictable cost, etc). Nevertheless he believes that the risks remaining after the taxpayer stumps up will be contained sufficiently to allow ?new financial products?. But he claims that as of today ?no major financial services provider offers pre-funded insurance against care costs?. This is disingenuous to say the least; apart from the fact that there are several such providers, there is also a number of providers of similar products which are not fully pre-funded but very often serve the purpose just as well. *(2)*

Furthermore, Dilnot?s idea that bringing in the state to take some of the risks will result in more insurance providers seems very wide of the mark. If taxpayers take on more risk that will reduce their capacity to take out insurance and will in any event mean a net loss of utility. *(3)* He ignores the point that governments are never interested in the long term. He misdiagnoses the relative paucity of care insurers; the real reason is the same as that which killed salary-related pension schemes ? endless regulatory intrusions from governments including the European Commission, plus Brown?s outright theft as mentioned above. (Both my wife and myself have policies which are no longer available to newcomers). *(4)* Insurers would need an enshrined law on no retrospective taxation.

Sadly most commentators accept Dilnot?s assertion that there are no current insurers, and often cite ?market failure? as the reason. It is disingenuous to reverse the blame in this way; what we are seeing is Government Failure. Insurers are risk takers; just get the regulators out of the way.

Admittedly LTC policies do face great risks due to the relationships between the movements of mortality rates and morbidity rates. It is very possible to see elderly people living longer and longer and thus needing more care than ever before. But all this does is to make LTC more expensive than would otherwise be the case; without insurance the problem would mean even greater depredations on taxpayers. There is no magic bullet. If the government wants a role (and it shouldn?t) why not insist that all retired people take out a LTC policy, just as motorist must have motor insurance? Then we can all watch LTC insurers grow forth and multiply! Indeed such a policy could often be part of a retirement package under revived occupational pension schemes.

In fact compulsion is a bad idea because it crowds out a number of private alternatives, as we shall see later.

A digression on the definition of what constitutes the private sector

Way back in their October 1974 election manifesto the Tories made their attitude to free markets very clear. Arguing against outright nationalisation, the manifesto said ?the desired results can be achieved just as effectively through taxation and regulation?. Since then (even in the Thatcher era) it has been made plain that if you want genuine free markets you can forget the Tories.

In recent years, the march to corporatism, in which government is the senior partner in industry, is rife. In this partnership Big Business often promotes state regulations to keep out pesky little competitors; not difficult because in large part the huge cost of regulations tends to be independent of size.

The benefits of corporatism to government are immense; if things go well government takes much of the kudos, while if they go badly it can, and does, blame the company. Good examples of corporatism today include (i) the railway industry, where government owns the track and dictates the prices of train journeys (ii) banking, where both the government and the nationalised Bank of England pull the strings to the point that few bankers (including Mervyn King) have any idea of what banking really is, and (iii) utilities, where Steve Holliday, the Chief Executive of the National Grid, announced ?I love the fact [that] we have seven regulators?. *(5)* Edison must be turning in his grave. Nowadays the major attribute for a CEO of such a company is a highly tuned political ear rather than an entrepreneurial spirit.

As Ross Clark wrote in the Spectator (11th June 2011) in an article specifically on care homes ?the problem with private provision is that in so many cases bureaucrats remain the direct customer?. Unfortunately he did not go on to the inevitable conclusion: the problem with public provision is the same with knobs on; only private companies, having no business with the bureaucratic public sector, are directed by what the ultimate customers want.

Hence in the most recent major scandal in a care home (Winterbourne View as shown by Panorama at the end of May 2011) was the result of the fact that Winterbourne, financed entirely by the NHS, had no paying residents.

To make this abundantly clear, let?s say a fruit wholesaler sells to Waitrose a batch of apples which, unknown to either party, has been contaminated with poison by some rogue employees at the wholesaler. Waitrose sells them on in good faith to customers who subsequently become ill. Would Waitrose get away with citing the wholesaler? Of course not; if it tried, its reputation would take a huge dive and customers would disappear in droves, making their individual alternative choices. This would happen in any case because of its failure to strictly monitor its wholesaler. All this happens without any state regulator such as a ?Food Quality Commission?. The only way customers can get what they want is if they can walk away and go elsewhere (as individuals, rather than in groups). In other words ?exit? not ?voice?.

Care in the Public Sector

Dedicated care homes are provided by the genuine private sector (as discussed above), hybrids involving Local Authorities, and the NHS. Wherever you look in the public sector you find many examples of scandalous treatment. Chutzpah is the only word to describe the NHS. Continuing Health Care package alongside its clear policy of ageism against the elderly ? and also alongside its policy of forcing them to endure long delays for treatment or to go private. Only last month the British Geriatrics Society found that the 400,000 elderly in NHS care homes were ?betrayed? by the lack of access to basic medical treatment.

Finally the scandals two years ago in several hospitals, including Mid-Staffs which suffered 1200 unnecessary deaths, and Basildon, to name but two, can never be forgotten. At the time, Cynthia Bower was the CEO of the Mid-Staffs Hospital. As a reward, she is now the CEO of the newly formed regulator, the Care Quality Commission (CQC). Such an appointment can mean only that the CQC is an attack dog to destroy private care homes or at least their independence while the State and Local Authorities run amok. *(6)*

The record of Local Authorities is abysmal in their directly-owned homes be they for the elderly or children. Meanwhile their policy of snatching children from their parents, increasingly on the flimsiest evidence at an alarming pace has similar results.

That?s all very well, you may say, but private care homes have their own scandals; what about Southern Cross, for example? There are two quite separate issues here; the first relates to the financial position of such homes, and the second relates to the influence of Local Authorities who pay for the care of the large majority in many homes in the same way as the NHS paid Winterbourne.

Firstly the finances of private care homes are essentially bound up with properties, the prices of which suffered heavily in the recession of the last three years, and which is still not over. (This too can be laid at the government?s door; its policy of artificially low interest rates fuelled the boom.) The second issue is the baleful influence of those Local Authorities who in many cases pay for a large number of residents, which immediately means that the relevant homes cannot be described as being in the private sector. In the past year or more the Local Authorities have squeezed mercilessly the amounts they will pay whilst continuing or increasing their own earnings and lifestyles.

In other words most of the damage to a majority of care homes is due to the fact that they did not forecast the recession, and little else. They were hardly alone! Yet most of the esteemed broadsheet newspapers simply parrot the phrase ?they should have factored it in?. Meanwhile several private care homes have learned their lessons and are deliberately trying to attract those who are paying their own way so as to escape the fickle Local Authorities. Welcome to the private sector, the true Big Society. Even as I write this, the private breaking up of Southern Cross appears to be proceeding as quickly and humanely as possible in the circumstances. *(7)*

Where have all the families gone?

Any sensible approach to LTC should start by acknowledging the failures of the welfare state; like Edison, Lord Beveridge must be turning in his grave. Of particular interest here is the large scale crowding out of families, friendly societies, and charities, with disastrous consequences. It is sad that most of today?s large charities in this field give ringing support to Dilnot instead of suggesting that they should open for business. Unfortunately many large charities have supped with the devil and become little more than deliverers for state benefits, often having accepted with open arms government funding to the tune of some 50% of their incomes.

The expanding welfare state has severed many families from any obligation to their parents, exacerbated by easy divorces, generally pooh-pooing the value of married parents, indeed penalising them in the tax and benefit system, and crowding out charities.

Naturally, similar interventions have been foisted on formal pension schemes with compulsory contributions for both state and private arrangements starting from an early age when other valid concerns are more pressing. State schemes are nearly always financed on a ?Pay-As-You-Go basis (PAYG) i.e. not funded, leaving benefits open to demographic changes so that PAYG is effectively Pay-As-You-Pray. This applies to many countries ? often via paternalism propelled by the World Bank, in turn often ignorant about the true situation especially in LCDs (less developed countries). Yet in Hong Kong, which until recently had no state pension system, retirement incomes were far higher than in other countries with state systems. Again, the real problem is crowding out by the Welfare State and government meddling. Not least here are the effects on parents and their decisions about when to retire and indeed about whether to have children, and if so, how many. There is every reason for government to step aside and allow insurers and revived occupational pension schemes to bundle LTC arrangements into a coherent package. *(8)*

Indeed there is every reason to remove all compulsion regarding saving for both retirement and long term care. All families and householders are different. It is absurd to insist that workers as young as 16 should be legally obliged to start salting money into ?National Insurance? arrangements. One can envisage that some households may find that it makes financial sense to prioritise other issues (such as paying back a mortgage as quickly as possible) for many years before even beginning to think about locking in savings for the rest of their careers as opposed to using ISAs and, for that matter, entirely informal saving for as much as half a career, before considering locking in funds for retirement and long term care.

Satisfying demand

With or without the Dilnot report, it will not be long before we see the burgeoning demand of potential new LTC residents. This situation is very similar to that of new schools, where Michael Gove will soon see that private finance is the only way to expand over a reasonable short time-scale. Perhaps he has already done so. It is now well known that the Swedish experience in school expansion was jet-propelled only because capitalists were allowed to tender, rather than Gove?s nonsensical limitation to local parents? groups and charities. *(9)* Other means of finance are limited to borrowing in one form or another, such as the PFI which has been a huge and costly mistake.

What kind of homes should be targeted for the future?

If you look into other parts of the developed world, such as the US or Canada or Australia, you will realise that three features are common ? the locations, the variation, and the facilities to move in three or more stages on the same complex from a personal home with little care, to a fully cared-for resident in a ?proper? care home.

It is worth suggesting here that ?being forced to sell one?s home to pay for LTC? should not be looked upon as wicked. On the contrary, it often makes very good sense all round. The maintenance of a house can become more and more difficult as the owner(s) get older; a purpose built suite in a congenial atmosphere can be bliss. This is a complex area especially for married couples but the shrill cries demonstrate a lack of thought to say the least.

By location, I mean primarily that there is often merit if the home is in a wider setting, containing facilities such as shops, cinemas, and so on. Many elderly people are unnecessarily isolated through lack of mobility.

Variation speaks for itself; with price one of the drivers. This is an important argument in favour of privately owned homes and the entrepreneurial spirit. It is impossible to be sure in advance what features will be the most popular so that building and equipping require risk capital. Local Authorities and the public sector generally are not only short of capital in the first place (rightly); also they don?t, and can?t, employ entrepreneurs, i.e. individuals who gain or lose directly according to their decisions.

Conclusion

To sum up, government should forget about funding long term care in any shape or form. At the current marginal tax rate of 50% (all taxes combined) every additional pound of tax reduces productivity (via a weakening of the division of labour) by more than 60%, net of all benefits, ignoring the costs of regulation and government waste. All that is required of government is to phase out the welfare state via sales to the genuine private sector.

References

1) My 2008 estimate of the losses involved was £225 billions; it is much greater now ? probably nudging £20,000 per household.

2) There are several types of insurance policies providing funds for LTC. It is true that if ?pre-funded? means that premiums are paid over many years (as in pension schemes) are rather thin on the ground at present and that this is partly due to the risks of mortality and morbidity together. But there is no reason whatsoever why such policies cannot be provided, given private demand, the revival of occupational pension schemes and a guarantee against retrospective tax claims. Examples include Friends Life, Partnership, British Friendly Society.

3) See my article onTax & the Division of Labour [3].

4) A recent example of the European Commission?s destroying the market is the proposal to end ?sex discrimination? in annuities caused by the fact that on average women live longer than men!

5) Originally banking was the safe storage of gold, for a fee. But bankers soon realised that many demand deposits lasted for long periods which provided the opportunity not only to cancel storage fees but to provide interest as well. That involves ?lending long? because interest comes out of the additional production from new capital provided by savers. Increasing the supply of fish by building a new boat can?t be done overnight. Demand deposits don?t fit the bill unless they are resilient. The Scottish bankers of 150 years ago held large fractional reserves of deposits (made in gold) and if any bank tried to steal a march on the rest it would be called to account immediately because inter-bank clearances had to be made daily, in gold. All this and more came from free markets.

6) See Reflections on Regulation; Experience and the Future, Adam Smith Institute.

7) Readers may want to look at the ASI blog on ?Lessons from Southern Cross [4]?.

8) See ?Pension Provision: Government Failure around the World? by Laveesh Bhandari and Philip Booth (Institute of Economic Affairs, 2008).

9) It is my understanding that Michael Gove may be reviewing his position on this issue.

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