Yale Center for the Study of Globalization

UHC Charter Expert Papers

TOPIC OF FOCUS

UHC must contribute to fostering economic development in the form of more and better paid jobs, not informal and precarious ones.

Santiago Levy

UHC must contribute to fostering economic development in the form of more and better paid jobs, not informal and precarious ones.

Santiago Levy

The obvious link between UHC and economic development is associated with the benefits that countries derive when their populations have broad access to high quality health services. On one hand, healthier workers can more actively participate in the labor market, learn new abilities and contribute to increase productivity. On the other, healthier children are better poised to learn more and perform better while they are in school; and in turn be more productive when they join the labor market. However, there are other links that are sometimes overlooked which, in some contexts, may offset the positive economic benefits from a healthier labor force. These links are associated with the dependency on access to health insurance on employment status and the mechanisms used to finance UHC. These links are relevant to all countries but are particularly important in developing ones with large informal sectors.

Employer-based health insurance may create rigidities that reduce productivity

Employer-based health insurance may generate "employment lock", "job lock" and "entrepreneurial lock". The first two occur when a person remains in a particular job, even if it does not meet their employment needs, or match their skills, in order to maintain their health insurance. When a country moves away from employer-based health insurance, studies show that occupational mobility increases and, in some cases, it enables workers to move into better and higher paid jobs. Similarly, "entrepreneurial lock" refers to when a person will not exit their job to become self-employed or an independent business owner because she cannot afford to lose their health insurance. These phenomena have negative impacts on individuals and the economy, in that they stymie upward labor mobility and entrepreneurship, and increase inefficiencies in the labor market.

Financing health services from payroll taxes may reduce formal employment

In developing countries, employer-based health insurance financed from payroll taxes creates additional economic costs. Clearly, these taxes can only be collected from workers hired by firms that are registered with the tax authorities; that is, firms that are formal and offer their workers formal jobs. Formal firms withhold these taxes, which are almost always set as a proportion of workers' wages. Firms try to pass on or shift back to workers at least part of these taxes, in the form of lower wages, so that in the end workers' health insurance is jointly paid by firms and workers. To the extent that payroll taxes cannot be completely shifted back to workers, firms' labor costs will be higher, and will translate into lower formal employment.

Moreover, in some countries, payroll taxes are used to finance not only health services, but other components of social insurance, like retirement, disability and survival pensions (and in some cases other benefits like day care services for children or labor training programs). This means that formal firms and workers have to jointly pay for a bundle of present and future goods and services. However, it is often the case that the value that workers attached to this bundle is less than the payroll taxes paid. This may be because the quality of the health services is low, because workers discount heavily their future pension, or because they may not need some of the services in the bundle.

The difference between the payroll taxes paid and the value of the benefits is equivalent to an implicit tax on formal employment. In response to this implicit tax, firms will reduce their level of formal employment and may decide to evade payroll taxes altogether. Evasion will depend on how countries enforce these taxes, and can take many forms, like under declaring the number of workers in the firm or their wages. However, since it is usually easier for smaller firms to evade, firms will tend to stay small. This behavior may make perfect sense from the point of view of the firm, but is costly in terms of productivity and growth, as economies of scale and scope are underexploited. Moreover, if firms are engaged in illegal behavior, they will be less likely to access credit and, more generally be able to engage in innovation, invest in training their workers and create high quality jobs.

But regardless of whether firms stay formal and reduce their level of employment in response to payroll taxes, or become informal and evade, the result will be lower employment in the formal sector (and fewer workers covered by employer-based health insurance). Lower formal employment will translate into a combination of more informal employment and higher unemployment, a mix that depends very much on country characteristics (although in general the mix will lean heavily towards more informal employment, as most developing countries have no unemployment insurance, and open unemployment is not high). The key point, however, is that reduced formal employment will hurt economic performance, since most studies show that informal jobs are on average less productive than formal ones.

Free health services for informal workers may increase informal employment

Countries funding health services through payroll taxes will never achieve UHC, even if these taxes were perfectly enforced and there is no evasion, and even if firms were able to fully shift back payroll taxes to workers in the form of lower wages. This is because not all workers participate in the labor market as employees of firms. Many workers are self-employed; others exploit their own plot of land in rural areas; and yet others may be employed in small firms where all workers are relatives (a family firm) and no wages are paid, but members are remunerated through profit-sharing arrangements (or do not receive any monetary remuneration but are paid in-kind).

In all these cases, payroll taxes cannot be collected because either there is no firm involved, or even if there is a firm, there is no payroll. All these workers are informally employed in the sense of not working with a registered firm that withholds payroll taxes. These workers account for a

large share of employment in developing countries, in many cases more than half. These workers will never be covered by employer-based health insurance. In addition, some workers in a firm where there is a payroll may also be informally employed because, as discussed, the firm breaks the law and evades payroll taxes.

At times informality and illegality are conflated, but from the point of view of UHC it is important to distinguish them sharply. The point is that even if the laws with regards to payroll taxes were fully enforced, many workers would be left out of a payroll-funded health system, for the simple reason that they do not receive a wage or a salary. Their earnings are more variable and sometimes the distinction between profits on capital and earnings on labor is unclear (as is the case of those working in a family firm, which in many developing countries is the most common form of business organization). Thus, UHC could not be reached through stricter enforcement of payroll taxes.

Informal workers create difficult trade-offs for governments seeking UHC. Because these workers will never be covered if health services are funded only from payroll taxes, the choice for the government is to leave them without coverage, or to fund their health services from a source of revenues other than payroll taxes. Faced with this trade-off, many countries have created parallel systems of health service provision funded from general taxation. The result is a segmented health system, one for formal workers and another one for informal ones; one funded from payroll taxes (usually bundled with pensions) and one from general taxation.

Funding health services combining payroll taxes and general revenues is bad economic policy and bad social policy

Creating two parallel mechanisms to provide health services to workers is far from an ideal solution, because the administrative costs are higher, and the scope of risk-pooling lower, making the overall system costlier. More importantly, from a social point of view the solution is undesirable because the quality and scope of services is usually not the same; in general, services for formal workers are better than for informal ones, thus defeating one of the aims of UHC (Precept One).

But the solution is even less desirable from the point of view of economic performance. The reason is that to the extent that health services for informal workers are paid from general government revenues, they are free from the point of view of workers. This creates an incentive for informal employment even if services are of lower quality than for formal ones. Indeed, workers get free health care if they have an informal job (self-employed or in a family firm); however, if they get a formal job, they must pay for their health care as firms shift back at least part of the payroll taxes in the form of lower wages.

Firms hiring workers will also react to the free provision of health services for informal workers. In the absence of these services, evading payroll taxes to fund health care means that workers are left without health coverage; workers will be less willing therefore to accept a in an evading firm. But when these services are present, evasion is easier, as now workers get benefits even if

the firm cheats; this may encourage the firm to share part of the payroll taxes evaded with workers in the form of slightly higher wages. And indeed, studies show that the introduction of free health services for informal workers, combined with costly services for formal ones, has increased informal employment and promoted illegal behavior.
Thus, the unfortunate result of the combination of employer-based health services funded from payroll taxes for formal workers, and health services for informal workers funded from general government revenues, is to tax formal employment and subsidize informal employment. The tax derives from the fact that firms cannot completely shift back to formal workers payroll taxes, and from the fact that payroll taxes are often used to fund not only health insurance, but also pensions and other services that workers may not value fully; the subsidy derives from the fact that workers get some health services that they do not pay for (nor the firm that they may be associated with), conditional upon them being informally employed. This tax-cum-subsidy combination is exactly the opposite of what is needed to increase productivity and accelerate growth.

UHC can best be sustained in growing and productive economies

Discussions of UHC at times fail to pay sufficient attention to the impacts of various forms of financing on economic performance. It is as is the issue of where revenues come from is immaterial, as long as there are sufficient resources to properly fund services. However, the sustainability of UHC depends on it being funded from sources of revenue that contribute to a more productive and growing economy.

On one hand, the combination of population aging and the epidemiological transition will put increasing pressures on health systems everywhere in the world. On the other hand, despite its central importance to social welfare, health competes with other priorities for resources. Conflicts over funding are much more difficult to resolve when good jobs are scarce, productivity fails to grow, and tax revenues are stagnant. In contrast, when workers have jobs where wages increase overtime because productivity is growing, and where tax revenues are increasing because the economy is expanding, UHC will be more sustainable.

Equity and efficiency considerations jointly support the proposition that UHC needs to be mostly funded from general tax revenues

Precept 3 argued that UHC required cross-subsidization and pointed out that this could be best achieved by funding health services from general tax revenues. Income and consumption taxes (including on energy) are the main sources of revenue in most countries. Almost everywhere, personal income tax rates increase with income levels, so that more income taxes are collected from richer tan poorer households. And consumption taxes, although usually having the same rates for all households, also collect more revenues from richer than poorer households, since consumption and income levels are very strongly correlated. When all households have access to the same quality publicly funded health services, cross-subsidization occurs most effectively. In parallel, Precept 4 argued that UHC required public funding to minimize out-of-pocket expenditures and ensure compulsory participation. This would prevent adverse selection, and

make sure that the pooling of risks occurred through the largest possible population. Precept 5 complements these arguments by pointing out that funding UHC from general tax revenues contributes to productivity and growth. This, in turn, generates the resources for the long-term sustainability of UHC, and creates conditions where workers con find better-paid jobs.