Understanding the contribution of fiscal space generation for healthcare financing in Latin America

Universal health coverage is a target aim where health systems reach a state where everyone can access healthcare services regardless of their ability to pay and while avoiding the incurrence of catastrophic costs. However, in light of rising healthcare costs, many countries are facing a major challenge in raising sufficient funds to achieve universal health coverage.

The need for efficient use of existing sources and for the identification and leverage of novel funding sources is high. WHO/PAHO recommends a benchmark level of public expenditure on health as a percentage of GDP for middle/upper middle-income countries at 6%. Governments can turn to the concept of fiscal space to achieve appropriate spending levels: creating the capacity in (national) budgets to be used for specific purposes without compromising financial stability and sustainability. Fiscal space assesses the need for new sources of health financing together with the efficient use of available resources by eliminating unnecessary and unproductive expenditures.

Study objectives

1. To study the possibility of creating fiscal space for healthcare financing in 10 Latin American countries.
2. To identify existing and potential sources of revenue to support the enhancement of fiscal space without endangering fiscal sustainability.
3. To provide conclusions in support of country-specific public policies for potential increases in and use of additional resources.

Methods

Primary and secondary data sources were used to (a) analyse key features of current health systems; (b) conduct an assessment of macroeconomic performance; (c) conduct a survey of stakeholders in the region on different funding mechanisms for healthcare services; (d) implement a series of simulation exercises to assess the feasibility of raising additional revenue via modest increases in indirect taxes (VAT, alcohol and tobacco taxes);

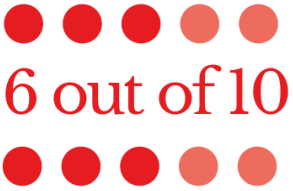
and (e) apply scenarios to highlight how this additional fiscal space could be used in practice.

Challenges for healthcare systems in Latin America

Key health indicators, such as infant mortality and life expectancy, are improving across the countries in the region. NCDs are the leading cause of death across the Latin American region and pose the highest burden on the healthcare systems and the resources available. The region faces several challenges in the financing, organization and delivery of healthcare, including ineffective delivery of care and slow uptake of policies to improve performance and efficiency.

Total health expenditure (% GDP) ranges from 5% to just over 9%, but for most countries in the region, public funded health expenditure is well below 6% of GDP. Health spending is coupled with high out-of-pocket (OOP) expenditure across the region: observed at a low of 16% of current health expenditure (Uruguay) and a high of 43% (Ecuador). While several countries rely heavily on general taxation to finance healthcare, large informal economies contribute to difficulties in tax collection and financing healthcare (and other public services) to an adequate level via taxation. Despite these trends, total health expenditure (% GDP) increased in most study countries over the past 15 years. Over that same period, OOP expenditure on health increased in five countries and private health expenditure increased in six countries.

Across the 10 countries, private (including out-of-pocket) spending accounts for 25-50% of total health spending



60% of study countries have out-of-pocket spending rates of more than 27% of total health expenditure

Data demonstrates that universal health coverage remains an elusive goal for the region to date, with most countries ranking in poor to moderate attainment of universal coverage across delivery, costs, and coverage.

Macroeconomic performance in the Latin American region

The fiscal space to increase healthcare expenditure is determined by a country's wider economic context. Countries facing adverse fiscal and other macroeconomic conditions may resist future increases in real health spending because these could undermine fiscal stability; by contrast, strong economic growth and sound macroeconomic fundamentals form the basis for fiscal space to materialize.

Overall, macroeconomic performance is not entirely positive for all study countries as a variety of macroeconomic instabilities remain in the region. However, these can be balanced out by positive growth levels, recovering commodity prices, and low inflation. In general, therefore, a debate on generating fiscal space for health is in a meaningful territory considering macroeconomic performance in the Latin American region.

Observed fiscal gap in public healthcare spending

What is the fiscal gap in health?

The gap between recommended benchmark spending and actual spending on health

While all healthcare systems in Latin America subscribe to the principle of universal health coverage, in practice only partial coverage is offered with a significant proportion of the demand for healthcare services being met through out-of-pocket spending. The difference between recommended benchmark levels of public health expenditure and actual spending constitutes the fiscal gap in public healthcare spending.

Most countries currently spend considerably below the 6% WHO/PAHO benchmark, with only Costa Rica and Uruguay meeting and slightly exceeding that benchmark. The average observed fiscal gap across the ten study countries between public spending on health (as % of GDP) and the benchmark health spend of 6% of GDP stands at 1.9% GDP (ranging from 1.1 to 2.9% of GDP across countries). In monetary terms, Brazil, Mexico, and Peru have the largest fiscal gaps to close in terms of additional resources required for their healthcare systems.

8 out of 10

8 study countries have public expenditure on health lower than the WHO recommended spending level of 6% GDP

Policymakers' perceptions of financing and efficiency mechanisms

Forming policy and deciding on equity-efficiency trade-offs in policy interventions involves political discourse and multidimensional stakeholder influence. A survey was conducted and considered values and opinions of several key sector stakeholders on perceptions and preferences for healthcare financing and health reform direction(s).

Stakeholders strongly agreed or agreed:

Based on an LSE survey of experts (n=673) from academia, government, healthcare providers, industry, and other organizations.

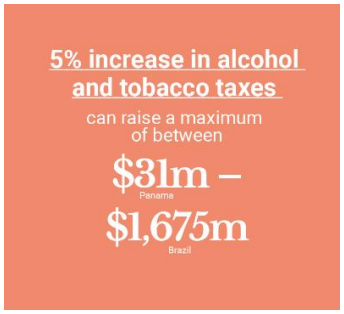
1. **Cost containment**
   Accompanying the generation of additional revenue with controls on current spending is necessary and politically feasible
2. **Resource allocation**
   Resources should not be reallocated to health from other publicly funded services
3. **User charges**
   User charges for healthcare services should not be increased
4. **Taxes on harmful products (sin taxes)**
   Taxes on harmful products can raise revenue and are politically feasible if earmarked
5. **Income tax and VAT**
   Stakeholders neither agree nor disagree on the necessity and feasibility of increasing income tax and lean toward the negative side vis-à-vis increases in VAT
6. **Health efficiency measures**
   Implementing health efficiency measures would be necessary and politically feasible

Modelling fiscal space for health

A simulation exercise was conducted to illustrate the feasibility of raising additional revenue via modest increase in indirect taxes: taxes on alcohol and tobacco (sin taxes), and VAT. Despite their regressive nature, indirect taxes were selected because the region is characterised by large informal economies, which suggest the tax base is limited to support meaningful income tax rises.

VAT increases can raise a significant level of new resources, which, if earmarked for the purposes of improving health services could make a significant difference. The ability to increase VAT rates in order to raise additional revenue for health and the corresponding increment in expected tax revenue depend on a variety of factors, including VAT rates, the overall VAT base, and the range of products subject to VAT.

Sin tax increases, particularly modest increases in alcohol and tobacco tax rates, can contribute to additional revenue generation. Overall, the ability of tax increases on alcohol and tobacco to generate significant tax revenue, was found to be small both in absolute terms as well as relative to key countries in the OECD region.



Political feasibility is critical and highlights the need to identify specific use as a justification for raising additional resources through taxation, also considering the regressive nature of indirect taxes, particularly for VAT. Earmarking the additional resources for specific purposes (e.g. improving quality of health services) would be critical and increase the degree of acceptability amongst the population. Overall, the ability of tax increases on alcohol and tobacco to generate significant tax revenue was found to be small both in absolute terms as well as relative to key countries in the OECD region.

Potentially feasible increases in taxation rates across the region

Standard VAT rates varied significantly in the region, ranging between 7% (Panama) to 22% (Uruguay). Countries implementing low VAT rates may have the capacity to implement an increase of up to 3 percentage points, whereas countries implementing high VAT rates may be able to raise VAT by one percentage point.

Tobacco and alcohol tax rates may be able to increase by more percentage points. However, the suitability and feasibility of applying tax increases on tobacco and alcohol products are very often contestable and dependent on country context: where countries are producers of such goods (e.g. wine in Argentina, Chile or Brazil, or tobacco in Colombia) tax increases on these goods might not be politically feasible or economically desirable. It may also artificially raise product prices for local goods and reduce local consumption, threatening the viability of local industry. However, the political feasibility

of raising indirect taxes might increase if the taxation proceedings are earmarked for the purpose of being used to improve the quality of health services.

Potentially feasible increases in taxation

COUNTRY	POSSIBLE % VAT INCREASE	POSSIBLE % HARMFUL TAX INCREASE
COSTA RICA, ECUADOR, PANAMA	3%	>>5%
MEXICO, BRAZIL, PERU	2%	>>5%
ARGENTINA, CHILE, COLOMBIA, URUGUAY	1%	>>5%

Simulation scenarios for the use of additional resources

Potential uses of the fiscal benefits from increased indirect taxation are (a) that all fiscal benefits should be earmarked for increased funding of healthcare services; (b) that healthcare should prioritised, but the fiscal benefits ought to be distributed on a weighted basis in accordance with other governmental priorities; and (c) the key use of fiscal benefits is placed on improving efficiency in the healthcare system.

If all additional tax revenue is allocated to health only, the VAT increases necessary are significantly lower than potential harmful product tax increases to fill the funding gap. Therefore, countries could look to VAT first to consider addressing funding gaps they have. If revenue generated is allocated to health in a way that addresses need in other areas of human services (e.g. education, pensions & social security, and defence), VAT and harmful product tax increases required to close the remaining fiscal gap are significantly higher than under the previous scenario.

Policy recommendations

Decision-makers are faced with increased pressure to accelerate towards universal coverage and need to actively consider the possibility of raising additional resources to fund health services, whilst simultaneously working towards improving efficiency in the allocation of existing resources. The concept of fiscal space, therefore, is far from theoretical and can provide significant opportunities to expand on the level of resources available. Still, there are several dimensions that need to be considered in order to ensure that appropriate decisions are taken:

The purpose of the modelling and simulation exercise pursued in the context of this study were not to advocate in favour of tax increases. Rather, it showcases that indirect taxes can be used effectively to raise additional revenue to invest in health. This can be done in varying degrees in the study countries, as their dependence on and exposure to indirect taxes (both VAT and taxes on alcohol and tobacco) differs quite fundamentally. Crucially, any potential meaningful tax rises, earmarked for health, need to be accompanied by policies focusing on efficiency and efficient use of resources in the healthcare system.