The Hidden Drain*

Why Health Care Reform is an Important Part of Economic Recovery

Recently, discussions around health care reform have begun in earnest among politicians and policymakers in Washington, D.C. and beyond. President Obama has spent the month of June hitting the trail and the airwaves making the case for reform,[1] and legislators are now aiming to pass a health care reform bill sometime this summer. With the possibility of comprehensive changes to health care on the horizon, it is important for leaders and policymakers—as well as citizens—to understand the full argument for reforming the health care system in the United States.

Many of the most compelling reasons for health care reform are medical or moral in nature, such as insuring the 46 million Americans without health coverage and expanding access to care. But health care is also an economic issue, and there is a strong case to be made that reforming the system is essential to the long-term recovery of our economy. At a health care reform summit in March, President Obama said that "[i]f we want to create jobs and rebuild our economy and get our federal budget under control, then we have to address the crushing cost of health care…"[2] This is exactly right. Health care is an ever-more-costly-burden that weighs down government, businesses, and workers alike. In the midst of recession, these costs become even more unbearable, greatly hindering all parties' ability to recover from economic catastrophe—and making health care reform a top priority.

Crippling Government Costs

This year, the United States is projected to spend a whopping $2.5 trillion on health care—about the same amount of money that the federal government has spent on recession-related bail-outs since December 2007.[3] (And this is without taking into account the indirect costs of an ineffective health care system, such as the $207 billion in economic losses that the U.S. suffers every year because of the poor health and shorter lifespan of people without health insurance.)[4] According to the most recent OECD data,

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[1] See for example, "Barack Obama: health care reform salesman in chief," *Christian Science Monitor*, June 15, 2009. http://features.csmonitor.com/politics/2009/06/15/barack-obama-health-care-reform-salesman-in-chief/

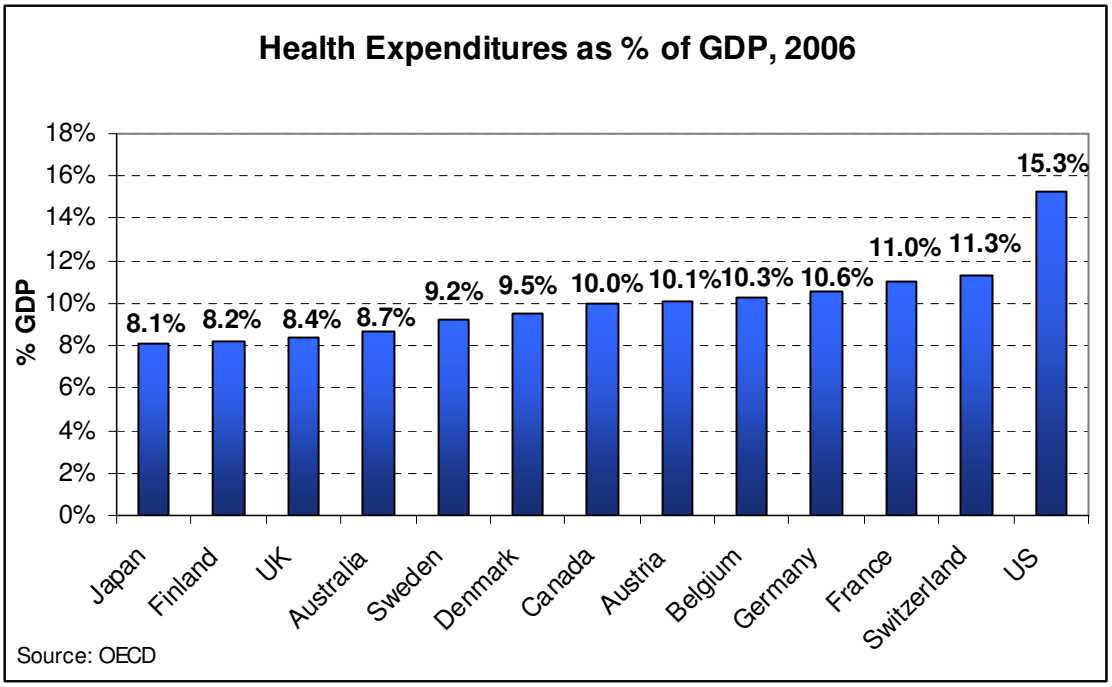
[2] "Obama: Health Care Reform Is A Moral – And Fiscal – Imperative." CBS News. March 5, 2009. http://www.cbsnews.com/blogs/2009/03/05/politics/politicalhotsheet/entry4845451.shtml

[3] "Follow the Money: Bailout Tracker." CNN.com. http://money.cnn.com/news/specials/storysupplement/bailout_scorecard/

[4] Elizabeth Carpenter and Sarah Axeen, "The Cost of Doing Nothing: Why the Cost of Failing to Fix Our Health System Is Greater than the Cost of Reform." New America Foundation, November 2008. http://www.newamerica.net/publications/policy/cost_doing_nothing

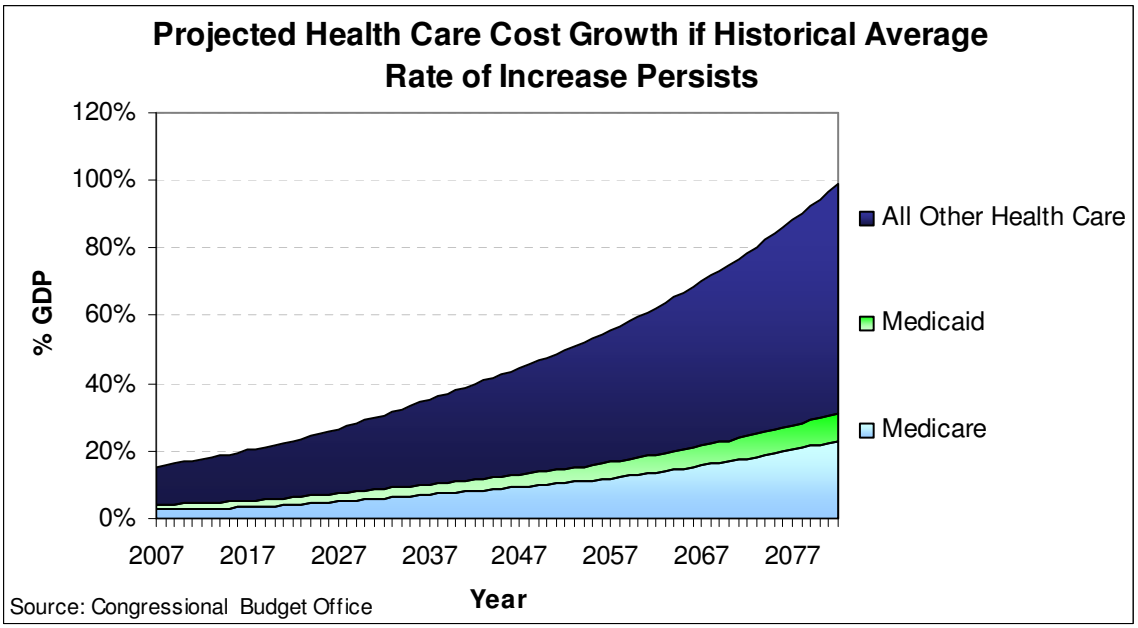
health care spending eats up more than 15 percent of the U.S. gross domestic product (GDP), a far greater proportion than in comparable countries around the world (Figure 1).

Figure 1



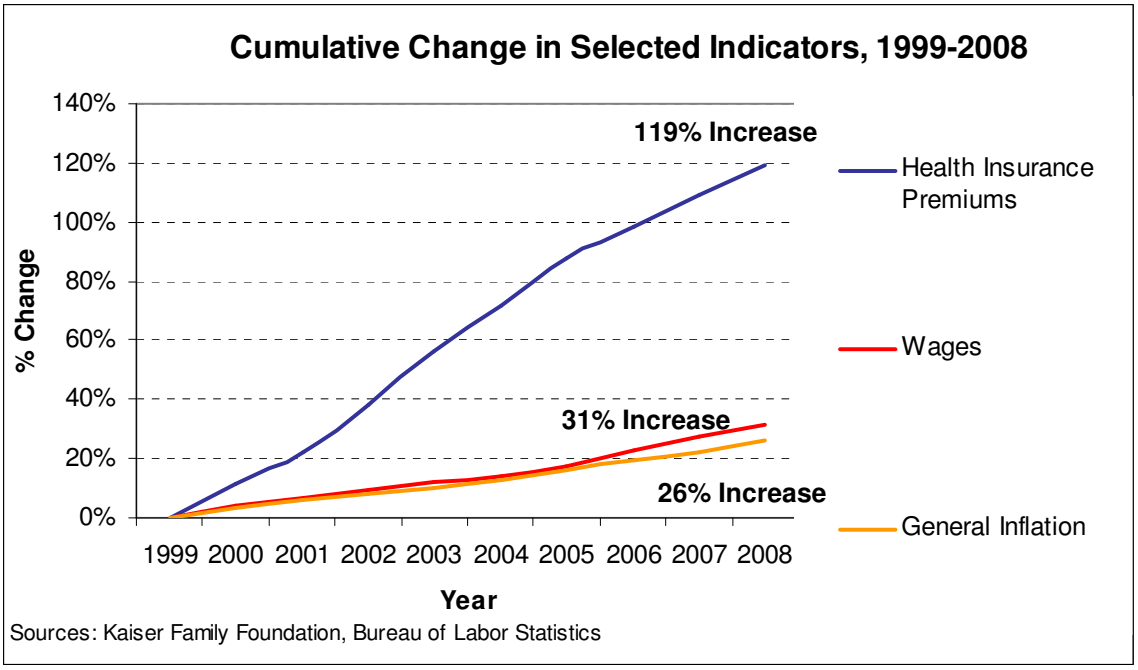
Such spending patterns are unsustainable. The Congressional Budget Office (CBO) projects that, should health care costs increase at their historical average rate, expenditures on health care would eventually consume a whopping 99 percent of the U.S. GDP. Though this is unlikely to come to pass—practically speaking, our system would collapse before reaching this point—it is still a sobering projection (see Figure 2).

Figure 2



Relentlessly rising health care costs make sudden economic shocks like our current recession all the more difficult for the U.S. to bear. Health care inflation has long increased at a much faster rate than other economic indicators, leaving less economic "cushion" in times of crisis for the public and private sector to pay for health care without squeezing out other spending priorities (see Figure 3). When the economy falters, health care costs don't—and as they keep increasing, they gobble up a larger share of the pie.

Figure 3



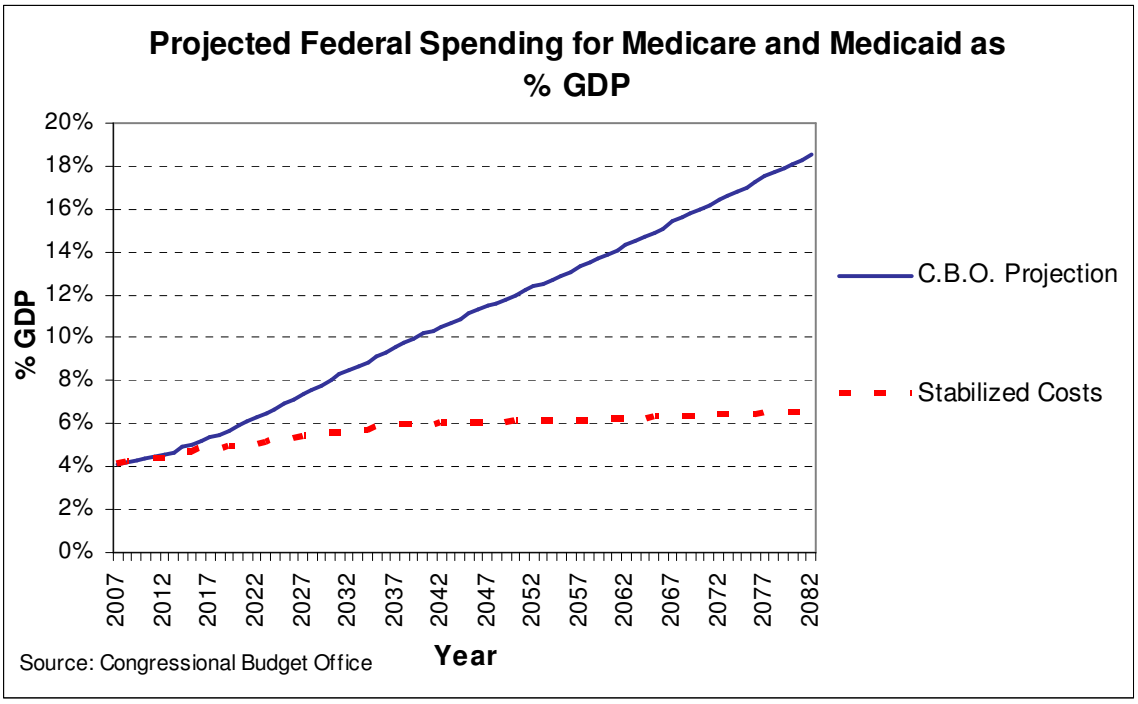
Indeed, the Centers for Medicare and Medicaid (CMS) expects the share of GDP devoted to health care to have its largest single-year increase ever in 2009—because the GDP is projected to shrink for the first time in forty years. CMS also projects that health spending will grow by an average of 6.2 percent each year between 2008 and 2018, 2.1 percentage points higher than the projected average annual growth in the overall GDP.[5]

Growing health care costs in a shrinking economy produce heavy fiscal burdens. As unemployment rises, more and more people lose employer-sponsored health insurance and turn to public programs like Medicaid for coverage. As a result, CMS projects that spending by private health insurers will reach a 15-year low in the 2009 period while spending by the federal and state governments is expected to grow from $1 trillion in 2008 to $1.2 trillion in 2009. At the federal level, the cost of health care is so systemically high that, even before the economic crisis hit, the CBO projected that—were lawmakers to implement some relatively modest cost-cutting reforms such as reductions of provider payments and comparative effectiveness research—federal costs for Medicare

[5] Andrea Sisko, Christopher Truffer, Sheila Smith, Sean Keehan, Jonathan Cylus, John A. Poisal, M. Kent Clemens and Joseph Lizonitz, "Health Spending Projections Through 2018: Recession Effects Add Uncertainty To The Outlook." *Health Affairs,* vol. 28, no. 2, February 2009. http://content.healthaffairs.org/cgi/content/abstract/hlthaff.28.2.w346

and Medicaid would still eventually consume close to one-fifth of the U.S. GDP (see Figure 4).

Figure 4



Burdening Businesses and Workers

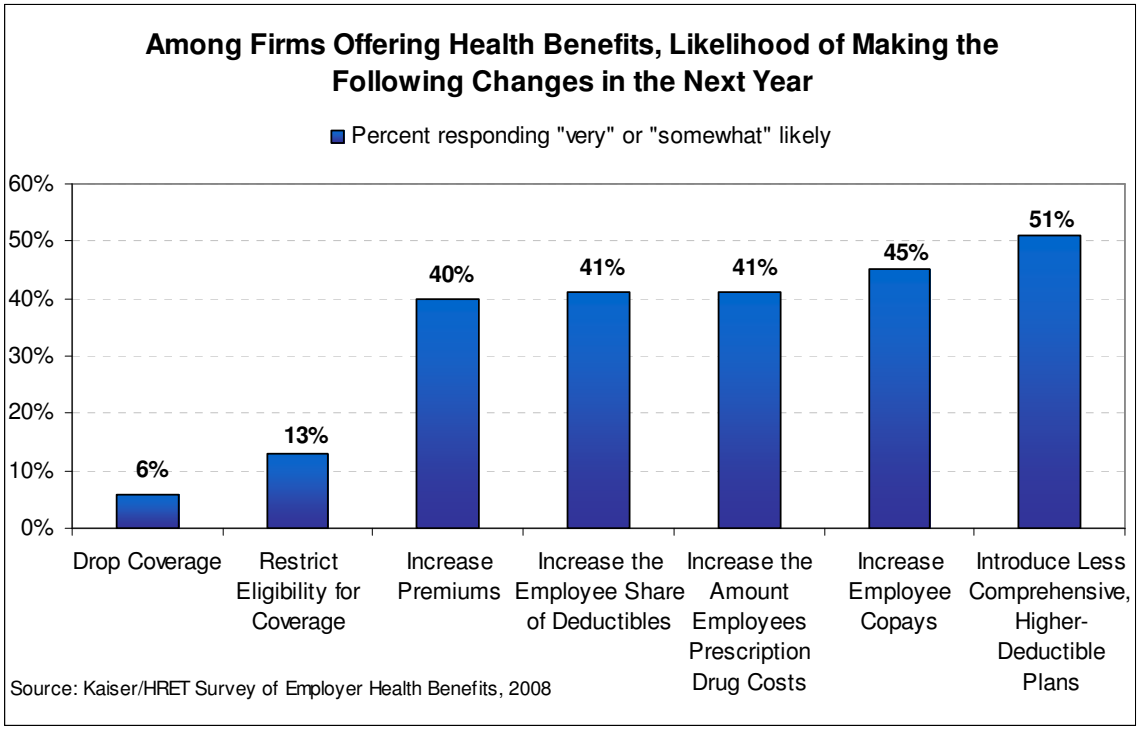
Health care costs burden the private sector as well. More than two-thirds of Americans receive health insurance through their employers; over the years the high cost of providing these health benefits has put a strain on businesses. Today, for example, manufacturing firms in the United States pay more than twice as much in hourly health costs as their major trading partners—$2.38 per worker per hour versus $0.96.[6] The combination of high costs and our employer-based system puts American companies at a disadvantage relative to international firms, which generally contribute less to employee health care and operate within less costly health care systems. Thus even before the recession came into full swing, health benefits were an appealing target for employers looking to reduce expenses, particularly since in the U.S., health benefits make up the second largest portion of employee compensation after wages and tips.

In fall 2008, the Kaiser Family Foundation's Survey of Employer Health Benefits found that over the next year a significant portion of U.S. businesses planned to reduce health care expenses by offloading more costs onto employees (Figure 5). A more recent survey from the benefits research firm Hewitt and Associates found that in 2009, four times as

[6] Len Nichols and Sarah Axeen, "Employer Health Costs in a Global Economy: A Competitive Disadvantage for U.S. Firms." New America Foundation, May 2008. http://www.newamerica.net/files/EMPLOYER%20HEALTH%20COSTS%20IN%20A%20GLOBAL%20ECONOMY.pdf

many firms are planning to move away from directly sponsoring health benefits within five years than were in 2008.[7]

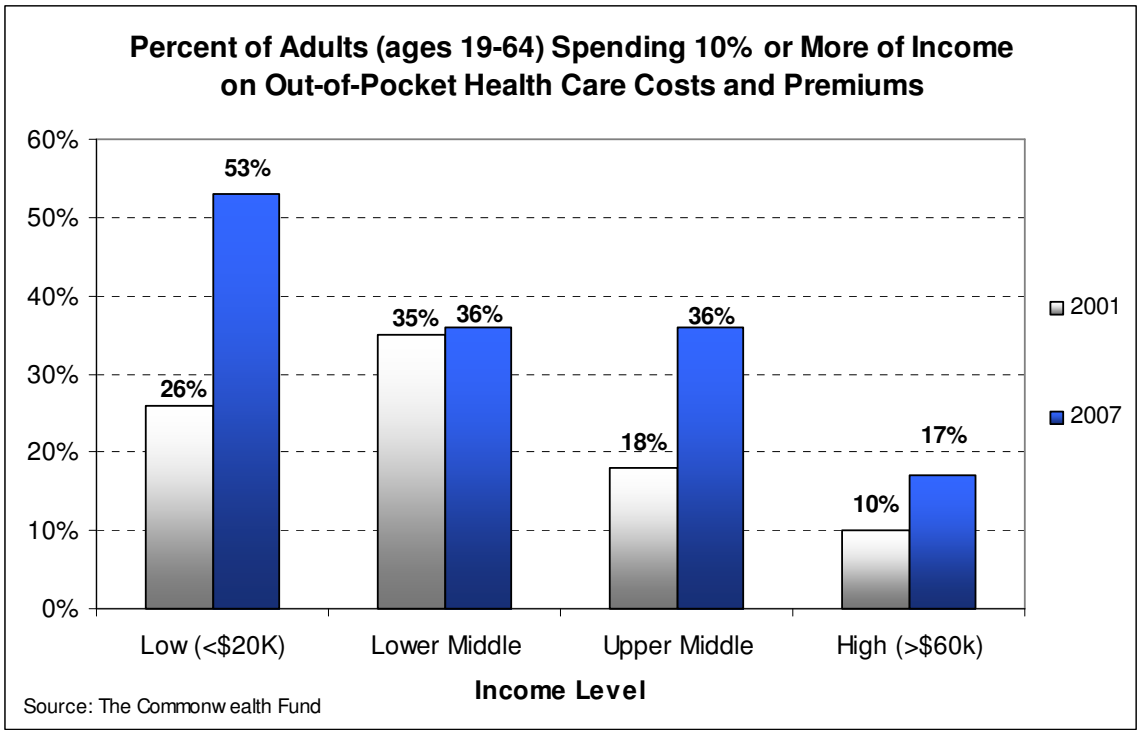
Figure 5



When employers look to reduce their share of benefit payments, workers have to pick up the slack through more expensive premiums, deductibles, and related expenses. The big problem is that for years, median wages for workers have been essentially stagnant—making additional out-of-pocket health care costs a significant drain on individual and household resources. As earnings growth slows and health care costs rise, the past few years have seen far more Americans of all income levels spending out-of-pocket for health care expenses such as premiums, co-pays, and deductibles (see Figure 6).

[7]"Challenges for Health Care in Uncertain times, 2009: Hewitt's 10th Annual Health Care Report." Hewitt Associates, LLC. January 2009. http://www.hewittassociates.com/_MetaBasicCMAssetCache_/Assets/Articles/2009/Hewitt_2009_Emerging_Health_Trends_Survey_Report.pdf

Figure 6

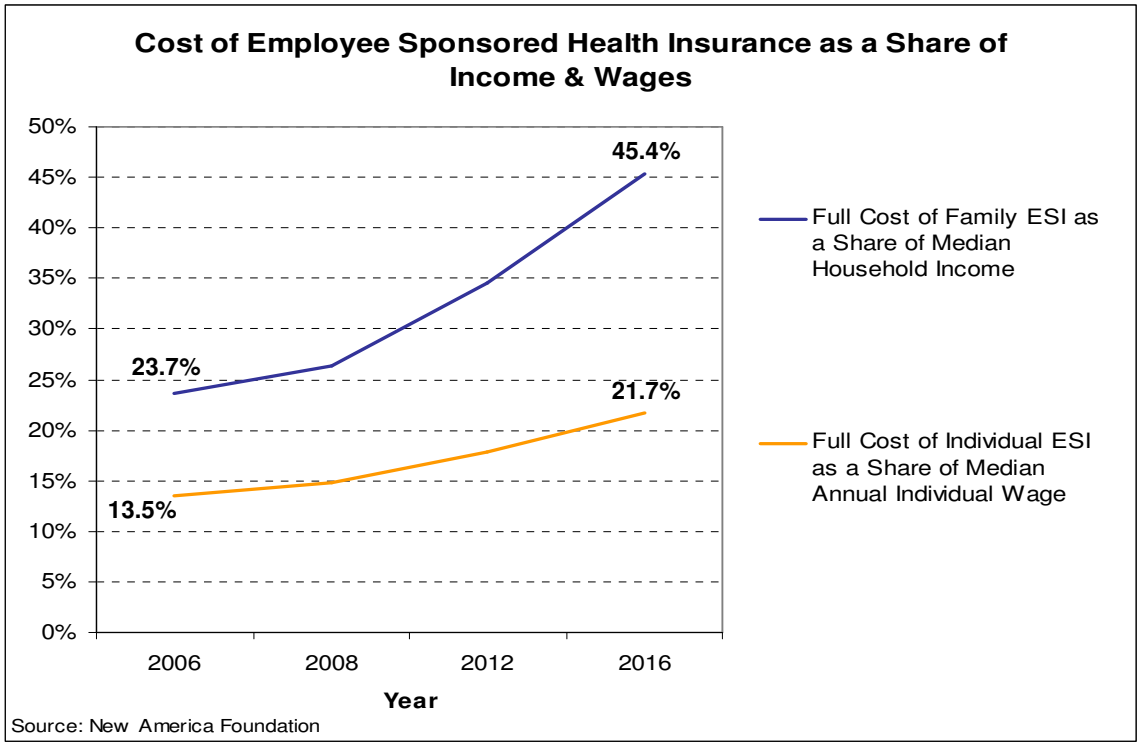


Some policymakers believe that an economic recovery will require encouraging consumers to pump money into the economy through increased spending. But this will be a hard sell if wages continue to stagnate and health care consumes a greater share of out-of-pocket expenses. This is true especially for Americans who do not have employer-sponsored insurance (ESI) and instead must shop for health insurance on the individual market. People who lack employer contributions to their coverage and must purchase it on their own will see anywhere from one-fifth to almost one-half of their income and wages go to health insurance in the coming years, leaving less money left for other spending or saving. Figure 7, which highlights how much individuals and families would have to pay for coverage equal to ESI insurance if they were to shop for these packages on the open market. Note also that these numbers are for the *average* health insurance plan; many people, including those in poorer health, will pay even more.

Yet even among workers who receive ESI, there is reason to be concerned about issues of equity. Under federal law, employer contributions to health insurance plans are not counted as part of workers' taxable gross income. This means that those workers who would have been taxed more heavily if employer health care contributions *were* considered taxable income—i.e. higher-income employees who fall into higher tax brackets—end up saving more. Further, generally better-off people are much more likely to be employed, and thus more likely to benefit from the ESI tax exemption. One study showed that 89.6 percent of workers with family incomes above 400 percent of the

federal poverty level were eligible for employer coverage, in contrast to 39.8 percent of workers with incomes below the poverty level in 2005.[8]

Figure 7



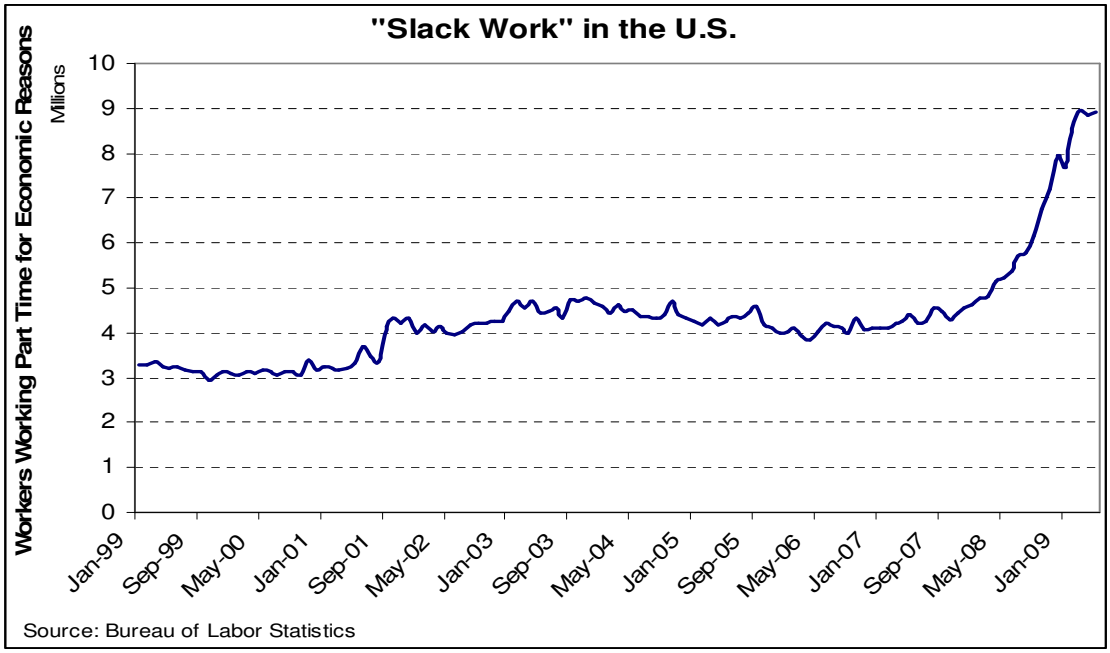
There are currently two federal provisions that provide tax savings to people who purchase insurance in the individual market. One is the 100 percent deduction allowed self-employed taxpayers who buy policies for themselves and their family members; this applies only to a small number of people (less than 3 percent of all who file returns). The other is the itemized deduction for unreimbursed specific medical expenses, which is claimed by only around 7 percent of taxpayers. Most people who purchase insurance in the individual market cannot claim either of these deductions.[9]

Research has also shown that high health care costs also have a negative effect on the overall labor market. Rising health insurance costs over the 1980s increased the hours worked by employees with health insurance by up to 3 percent, because employers were opting to hire fewer people and work existing employees longer in order to avoid taking on new benefits packages.[10] More recent research from the University of California and Harvard University found that higher health care costs have a direct effect on employment prospects through a trickle-down effect in which employers save money by

[8] Bob Lyke, "The Tax Exclusion for Employer-Provided Health Insurance: Policy Issues Regarding the Repeal Debate." Congressional Research Service, November 21, 2008.
http://www.allhealth.org/BriefingMaterials/RL34767-1359.pdf
[9] Ibid.
[10] David Cutler and Brigitte Madrian, "Labor Market Responses to Rising Health Insurance Costs: Evidence on Hours Worked." RAND Journal of Economics, Vol. 29 (1998): 509-530.
http://www.nber.org/papers/w5525.pdf

hiring fewer workers and offering more part-time positions. In fact, the authors found that a 20 percent increase in health insurance premiums reduces a given worker's probability of being employed by 3.2 percent and increases the likelihood that a worker is employed only part-time—where health benefits are very uncommon—by 1.9 percent.[11] Given recent trends in unemployment and the increasing number of Americans engaged in "slack work"—involuntary part-time work that usually lacks benefits and is forced on workers by employers looking to cut costs—the impact of health care costs represent an important stumbling block to developing a robust labor market (Figure 8).

Figure 8



A Necessity for Recovery

High health care costs inhibit economic recovery in many ways: they consume ever more of our economy at a time when effective public spending and economic restructuring is absolutely critical and burden employers and workers who face stagnant wages, a more insecure labor market and higher out-of-pocket health care costs. Ultimately, these problems can only be addressed through comprehensive reform aimed at the factors that drive up health care prices. Potential reforms include:

[11] Katherine Baicker and Amitabh Chandra, "The Effect of Increases in Health Insurance Premiums on Labor Market Outcomes." Employment Policies Institute, January 2006. http://www.epionline.org/studies/baicker_01-2006.pdf ; Katherine Baicker and Amitabh Chandra, "The Labor Market Effects of Rising Health Insurance Premiums." *Journal of Labor Economics*, July 2006, Vol. 24, No. 3: pp. 609-634 http://www.journals.uchicago.edu/doi/pdf/10.1086/505049.
Note that these numbers come from more prosperous economic times—given current economic realities , it's reasonable to assume that the negative labor market pressures of higher health care costs are even more powerful today.

- expanding coverage in order to more effectively pool risk and eliminate increased costs for the insured, who currently pay more in order to subsidize unpaid care for patients without health insurance;

- greater institutional focus on prevention and wellness instead of costly interventions late in life;

- the development of health information technology such as interoperable health information systems and decision support tools to minimize redundant tests, adverse drug interactions, and other expensive—and dangerous—inefficiencies;

- instituting comparative-effectiveness research so our system doesn't pay for ineffective, duplicative treatments and both doctors and patients can have a clear understanding of what tests and treatments are most effective;

- and reforming provider reimbursement schedules to encourage high-quality, efficient care, instead of high-volume, expensive care.

These changes will not come cheap, nor will they be easy to implement. But in the long-term they will address the health care costs that threaten our capacity to pursue meaningful economic recovery by freeing economic resources, improving the fiscal health of the public sector, and reducing economic burdens on businesses and workers.

Further Reading

Katherine Baicker and Amitabh Chandra, "The Effect of Increases in Health Insurance Premiums on Labor Market Outcomes." Employment Policies Institute, January 2006.

Elizabeth Carpenter and Sarah Axeen, "The Cost of Doing Nothing: Why the Cost of Failing to Fix Our Health System Is Greater than the Cost of Reform." New America Foundation, November 2008.

Bob Lyke, "The Tax Exclusion for Employer-Provided Health Insurance: Policy Issues Regarding the Repeal Debate." Congressional Research Service, November 21, 2008.

Len Nichols and Sarah Axeen, "Employer Health Costs in a Global Economy: A Competitive Disadvantage for U.S. Firms." New America Foundation, May 2008.

"The Case for Health Reform: The Moral, Economic, & Quality Motives for Action", New America Foundation, February 2009.