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Engelberg Center for Health Care Reform

THE ECONOMIC IMPACT OF HEALTH CARE REFORM

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Welcome and Introductory Remarks:

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Presentation:

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Panel Discussion:

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MS. ROMER: Thank you. It is wonderful to be here, and what Mark said is so absolutely true. I think of myself as a macroeconomist, an economic historian, and it is true, you only have to be in Washington a very short while to realize that there is no more important issue than health care and so that's what I'm going to be talking about this morning.

This morning the Council of Economic Advisers released a report entitled "The Economic Case for Health Care Reform." The key contribution of the report to my mind is to show that if we do research reform well, the benefits to the economy will be enormous. If we can genuinely restrain the growth rate of health care costs significantly while assuring quality, affordable health care for all Americans, living standards would rise, the budget deficit would be much smaller, unemployment could fall, and labor markets would likely function more efficiently. Because the economic benefits that we identify depend crucially not on just doing health care reform but doing it well, we hope that this report will help strengthen the resolve of policymakers to undertake the serious changes that are necessary.

The report has four key sections. The first discusses some key projections of what's likely to happen in the absence in the health care sector without successful reform; if you want, it shows the cost of doing nothing. One fact that's well known is that health care expenditures in the United States are currently about 18 percent of GDP, by far the highest of any country. These expenditures are projected to rise sharply. By 2020, our projections suggest health expenditures could be roughly one-third of total output in the U.S. economy.

For households, rising health care expenditures will likely show up in rising insurance premiums. Even if employers continue to pay the lion's share of premiums, both economic theory and empirical evidence suggest that this trend will show up in stagnating take-home wages. So this figure which is Figure 3 from our report shows our projection of total compensation, that's the top line, and compensation less insurance costs, that's the lower dashed line, both in inflation-adjusted dollars. We project that without reform, the noninsurance part of compensation will grow very slowly and likely fall eventually as premiums, that wedge between those two lines, rise sharply over time.

Rapidly rising health care costs also means that government spending on Medicare and Medicaid will rise sharply over time. Our projections suggest that these expenditures which are currently about 6 percent of GDP will rise to 15 percent of GDP by 2040. In the absence of

tremendous increases in taxes or reductions in other types of government spending, this trend implies a devastating, and, frankly, unsustainable rise in the federal budget deficit.

Another trend that's well known but too crucial to be ignored is the rise in the number of Americans without health insurance. Currently 46 million people in the United States are uninsured. In the absence of reform, this number is projected to rise to about 72 million by 2040.

The second key part of our study looks at the inefficiencies in the current system and the market failures that lead to our lack of insurance. It's important to diagnose the problem before one can sensibly discussion solutions. This part of the report also discusses the key goals that the President had laid out for reform. One is to slow the economic rate of health care costs while maintaining and chose of doctors and plans, and another is to expand health insurance coverage to all Americans. Since reform plans are very much in the process of being developed cooperatively with the Congress, we don't describe in detail the reforms that would enable us to achieve these goals, but to make the analysis credible, we give a sense of the kinds of changes that might be implemented. We also survey the evidence, must of it from international comparisons and for comparisons across different parts of the United States that there is substantial inefficiency in the current system. This is important for making the case that slowing the growth rate of costs by

improving efficiency is absolutely possible. For example, our estimates suggest that we could slow cost growth by 1.5 percentage points per year for almost a quarter of a century before we would have exhausted the existing degree of inefficiency.

However, I don't want to sugar coat the situation. Slowing cost growth by 1.5 percentage points per year may sound small, but it is likely to be very challenging. It will take an incredible degree of resolve and cooperation among policymakers, consumers and providers to bring this about, but what our study shows that it should be possible. More fundamentally, what our study shows is that the economic benefit of slowing cost growth would be enormous. This is in fact the conclusion of the third key part of our study which looks at the economic effects of successful reform.

In our study we examined the effects of cost containment and coverage expansion separately, but obviously the two are related. For example, expanding coverage is likely to make certain types of cost containment easier to achieve.

In our analysis of cost containment, we focus on slowing the growth rate of costs. This is the so-called curve bending that can last for decades. This is quite separate from actions that we might take immediately to cut the level of government medical spending such as the roughly $300 billion of Medicare spending cuts proposed in our budget.

These immediate level changes are unquestionably important for paying for the expansion of coverage in the next decade, but for thinking about the changes that will save us from the unsustainable long-run trends that I've been discussing, slowing cost growth year after year is essential, and that's what we focus on in our study.

You're also going to see that we consider various degrees of cost containment. In particular, we're going to look at the effects of slowing the annual growth rate of annual health care costs by the 1-1/2 percentage points that's really been the focal point of much of the discussion. We're also going to look at smaller levels, 1 percent or half a percent. To be conservative, we're also going to assume that it's going to take a few years before any genuine curve bending could kick in.

The fundamental thing that slowing cost growth does is to free up resources. If we restrain costs by eliminating waste and inefficiency, we can have the same real amount of health care with resources left over to produce the other things that we value; this causes our standard of living to rise.

We analyzed the effects of freeing up resources in a standard growth accounting framework. For those of you who like equations, the framework is spelled out in an appendix to the report. The President had great fun with that yesterday. I told him that there was actually a version with calculus if he wanted it.

Nothing says how we would use those freed-up resources. We may spend some of them on increasing the quantity of health care by expanding coverage. We may spend some of them on increasing the quality of health care as well. But the crucial finding of our analysis is that we can have a lot more of the things that we value as a country if we slow the growth rate of health care costs.

We then expand our framework to analyze what slowing cost growth would do for the deficit and capital formation or investment. Because the government is a major provider of health care, slowing the growth rate of health care costs would lower the government budget deficit and therefore increase public saving, and efficiency gains that raise income would lead to some additional private saving, and all of this increased saving would tend to lower interest rates and encourage investment. That extra investment tends to increase output even more.

Our estimates suggest that the combined impact of greater efficiency in health care and greater investment is very large. One way to make these effects concrete is to translate them into income for a typical family of four in constant dollars. These effects are shown in this figure, Figure 15 from our report. The bottom line shows the projected path of family income without any health care reform. The higher paths show family income under different degrees of cost containment, so the top line shows if we can manage to slow cost growth by the 1-1/2 percentage

points. What you find is if we do that, family income would be about $2,600 higher in 2020 than it otherwise would have been; by 2030 it's nearly $10,000 higher.

I also want to show you what our analysis implies about the effect of health care cost containment on the federal budget deficit. Here I need to be very clear that our estimates are not official budget projections that would be based on detailed projections of costs and revenues. They're much more a back-of-the-envelope calculation. And they do not include the costs of coverage expansion because most of those costs will be covered by the spending cuts and the revenue increases that are currently under discussion. Our numbers really focus on the effect of slowing cost growth over the long term.

What we find is that the effects on the deficit are very large. So this figure, which is Figure 14 from our report, shows the deficit reduction in key years. If we can slow cost growth by 1.5 percentage points, that's the purple columns, in 2030 the reduction in the deficit would be 3 percent of GDP. By 2040 what you see is that it would be 6 percent of GDP. These numbers illustrate the crucial truth that serious health care cost growth containment is the number one thing that we can do to ensure our long-run fiscal health. Health reform is just simply central to long-run fiscal stability.

Another possible macroeconomic effect of cost growth containment is perhaps a short-run impact on unemployment and employment. When health care costs are growing more slowly, wages can grow without firms' costs rising, so firms do not raise prices as much. This allows monetary policy to lower the unemployment rate while keeping inflation steady. Studies show that this mechanism was one source of the unusual prosperity of the 1990s. Widespread replacement of fee-for-service medicine with managed care led to a period of much lower health care cost growth which contributed to the unusually low unemployment rates in the mid- and late-1990s. Our estimates suggest that slowing cost growth by 1-1/2 percentage points per year would lower normal unemployment by around a quarter of a percentage point. This translates into an increase in employment of about 500,000 jobs. While this is surely not a permanent effect, it could last for a number of years.

The fourth and last part of the report discusses the benefits of coverage expansion. The most important of these involves the economic well being of the uninsured. We used the best estimates available to try to quantify the costs and benefits of expanding coverage to all Americans. Among the benefits that we try to put a dollar value on are the increase in life expectancy and the decreased chance of financial ruin from high medical bills. The costs to society of covering the uninsured represent a mix a public and private costs and come from existing studies,

not from any estimates or plans currently being contemplated by Congress.

Not surprisingly, we find that the benefits of coverage to the uninsured are very large, but crucially, we find that the next benefits, the benefits minus the costs, are also very large, roughly on the order of about $100 billion per year, or about two-thirds of a percent of GDP.

Another effect of expanding coverage that we consider is increased labor supply. With full health care insurance coverage, some people who would not be able to work because of disability will be able to get health care that prevents disability. They would therefore be able to stay in the labor force longer. A related effect is that some workers currently in the labor force would be more productive with better health care. How large these effects might be are hard to predict and there could be offsetting effects, for example, with a better insurance market, some workers who are working just to get health insurance might retire earlier. But we believe that the net impact on effective labor supply will be positive and will further increase GDP.

The final impact that we identify is the effect of expanding coverage on the efficiency of the labor market. Expanding coverage and eliminating restrictions on preexisting conditions could end the phenomena of job lock where worries about health insurance cause workers to stay in their jobs even when other jobs that pay more or maybe

are a better match is available. Our estimates based on a range of economic studies are that this benefit could be about two-tenths of a percent of GDP each year.

Similarly, we examined the fact that small businesses are currently disadvantaged in the labor market because employer-sponsored health care insurance is so expensive for them. Moving to an insurance system that removes this disadvantage would be beneficial to the competitiveness of the crucial small-business sector of the economy.

The bottom line of our report is that doing health care reform right is incredibly important. If we can put in place reforms that slow cost growth significantly and expand coverage, the benefit to American families, firms and the government budget would be enormous. To put it simply, good health care reform is good economic policy.