

The next big US economic policy debate: not bank bailouts, but healthcare reform

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- President Obama has staked out a broad agenda for domestic policy reform and one of his top priorities is to move to universal health insurance coverage of all Americans. That would be exorbitantly expensive without major efforts to control escalating medical costs in a sector that already accounts for over 15% of GDP and over 20% of personal consumption expenditures.
- Influential Republican members of Congress have said privately that the debate over healthcare reform will be the most important and controversial issue that the Congress will take up over the next six months, more contentious than either bank bail-outs or the administration's budget request.
- The last time the issue was seriously address by the US government was at the beginning of the Clinton administration. It was defeated by well-organized attacks from insurance companies, drug manufacturers, and some physicians' groups who convinced the public – and thus the majority of legislators – that the Clinton White House was intent on imposing rationing of medical care to hold down costs.
- Opposition to the outlines of the Obama healthcare reform plan has been slow in emerging, but the public has weighed in with concerns of its own. In a nutshell, the average voter distrusts the government to run the healthcare system. Unless the president can overcome these misgivings, the chances of success are poor.

Some basic facts

The Commerce Department reckons that expenditures on medical care & goods are now running over \$2.1 trillion or about 21.5% of total consumer spending. That translates into a share of GDP of close to 16%. The sector is the largest single component of the GDP and the fastest growing, with an average annual rate of increase of 7.2%. Health care employment represents more than 10% of non-farm payrolls and has grown by 2.5% just in the last twelve months. By comparison, total non-farm payrolls have dropped 3.5% during that period. Price inflation in the sector has simmered down over the past two decades, in part in response to tougher reimbursement rules by both private insurers and the government-run Medicare and Medicaid programs. But costs continue to climb: by 2.5% over the past year in the CPI, as compared with 0.4% for the total CPI.

Fallacies about the structure of the US healthcare system abound. For instance, the myth is that the US has largely a privately-run system. The reality is that the US has a mixed system, almost equally divided between the public sector, including Medicare and Medicaid, Veterans Administration, and State run programs, and private insurance. At the federal government level, healthcare expenses amount to about a quarter of total outlays or roughly 5% of GDP, about the same as retirement benefits under Social Security. Those shares will at least double over the next twenty years, as the baby-boomers retire.

Another fallacy is that the system could be fixed relatively easily through a “market-based mechanism” if healthcare consumers, which is essentially everybody, were forced to take cost into account in deciding on what medical procedures to “buy”. It's nonsensical on the face of it, because only a tiny proportion of the population has the level of advanced education necessary to make an informed choice. And it's even sillier to contemplate for the sick or the elderly to make such life-and-death decisions at a time when they are scared and in pain. Even generally pro-market Republicans now appreciate that “market-based mechanisms” are a non-start that would involve that would involve a far more radical change in the present system than either major political party is now or has ever contemplated.

The fact is that at present only 15% of the population pay medical expenses out of pocket. In other words, 85% of the population is presently insured, either through their employer, who contracts with a private

insurance company, or by purchasing an individual health insurance policy on their own, or through a government-run program (virtually all elderly citizens are insured by Medicare). The issue is how to deal with that 15%, while trying to come to grips with cost escalation that threatens long-term stability of the government budgets and the financial health of companies and their workers.

What the Obama team proposes

The White House makes it easy for anyone to get a quick reading on what the president's wish list is for an improved healthcare system. Here are their priorities:

Medical insurance improvements:

- Require insurance companies to cover pre-existing conditions so all Americans regardless of their health status or history can get comprehensive benefits at fair and stable premiums.
- Create a new Small Business Health Tax Credit to help small businesses provide affordable health insurance to their employees.
- Lower costs for businesses by covering a portion of the catastrophic health costs they pay in return for lower premiums for employees.
- Prevent insurers from overcharging doctors for their malpractice insurance and invest in proven strategies to reduce preventable medical errors.
- Make employer contributions more fair by requiring large employers that do not offer coverage or make a meaningful contribution to the cost of quality health coverage for their employees to contribute a percentage of payroll toward the costs of their employees' health care.
- Establish a National Health Insurance Exchange with a range of private insurance options as well as a new public plan based on benefits available to members of Congress that will allow individuals and small businesses to buy affordable health coverage.
- Ensure everyone who needs it will receive a tax credit for their premiums.

Reducing Costs:

- Lower drug costs by allowing the importation of safe medicines from other developed countries, increasing the use of generic drugs in public programs, and taking on drug companies that block cheaper generic medicines from the market.
- Require hospitals to collect and report health care cost and quality data.
- Reduce the costs of catastrophic illnesses for employers and their employees.
- Reform the insurance market to increase competition by taking on anticompetitive activity that drives up prices without improving quality of care.

Even a casual review of these points identifies where the main opposition to the Obama administration's plans will come from: private insurers and drug companies. But what's different from the failed Clinton administration's initiative in 1993 is that physician groups are arguing for many of the same changes. What bothers doctors most is an undisciplined legal system in which malpractice suits can destroy a doctor's

practice, while malpractice insurance premiums have become exorbitant. To the extent that the president is able to take on one of the biggest supporters of the Democratic Party, plaintiff lawyers, and rationalize the tort system, he will gain a lot of support.

First steps have already been taken

The head of the Office of Management and Budget, Peter Orszag, formerly the chief of the Congressional Budget Office, is one of the key players in healthcare policy. This week he gave a speech covering administration policies toward both education and health care. He stressed that significant healthcare policy initiatives were inserted in the fiscal stimulus package. They include especially USD19 bn to help computerize US health records; USD1.1 bn for technology assessment to determine using scientific methods which medical procedures work and which don't; USD1 bn for prevention and wellness treatment to reduce the impact of chronic diseases; and USD500 mn to develop more healthcare professionals, including doctors and nurses. Equally important is a USD21 bn appropriation for basic scientific research, with a major emphasis on biomedical sciences.

But it is a long way from these useful and not particularly controversial steps to the vastly more complicated and more expensive arena of government guarantees for universal coverage. On this the White House website has this to say: "Barack Obama will pay for his USD50-65 bn health care reform effort by rolling back the Bush tax cuts for Americans earning more than USD250,000 per year and retaining the estate tax at its 2009 level." That would be USD50-65 bn per year, not one time. And Republican opposition to the financing proposal was easily matched or exceeded by the opposition of several Democrats in the Congress to Obama administration proposals for limiting charitable deductions and other revenue measures. The NY Times concluded this week that "President Obama is running into stiff Congressional resistance to his plans to raise money for his ambitious agenda, and the resulting hole in the budget is threatening a major health care overhaul and other policy initiatives."

What the public thinks

There are probably more public opinion research outfits questioning US citizens about their attitudes about the healthcare system than any other important economic and social issue. And they have been conducting these polls for a long time, so it is possible to trace changes in the views of the public. Polling results continue to have great influence on Washington, both the Congress and the administration. What are the people saying now and how are their views changing?

Universal coverage: Respondents have generally supported government efforts to guarantee medical insurance for everyone but they are not as inclined to pay higher taxes to pay for it as they were fifteen or twenty years ago. When asked whether universal coverage is more important than keeping medical costs down, a majority prefers universal coverage but the proportion that cites controlling costs is steadily rising. The latest split was 54-40, as compared with 65-31 two years ago. Undoubtedly, the recession and steep drop in household wealth have blunted the support for universal coverage.

Technical assessments: Another recent poll asked whether respondents would accept the judgments of an outside scientific group on the effectiveness of tests and treatments. If done by a panel of experts from an independent scientific organization, 55% would trust the recommendations. If done by a scientific panel selected by the government or by a government agency such as the National Institutes of Health, only 41-42% would accept the recommendations. Incidentally, our own (unscientific) questioning of doctors in the New York area concludes that they are still somewhat leery of technical assessments. But they are coming around to the view that it may help them stave off malpractice suits. Many admit that they authorize a number of tests simply to protect themselves from litigation.

Implications for the markets

The health care paradox in the United States is that the country has some of the leading companies in the world in industries such as medical equipment, pharmaceuticals, and systems design. These are companies with strong balance sheets, exemplary profitability, top science, and global presence. But the US healthcare system itself is generally mediocre, apart from the high end surgical and cancer capabilities that attract patients from all over the world at the high end. And preventive medicine and healthy life style promotion is actually demeaned (not least by fast food chains).

But there is no doubt that the reputation and overall global clout of the Obama presidency would be enormously enhanced if the team is skillful enough to put through a meaningful set of reforms – as well as a credible way of paying for it. Expectations are not high. Failure would not be punished by the markets. But success would be good for the stock market and good for the dollar in the exchange markets. Stay tuned, this is a hugely important issue and is only just beginning to be noticed.

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