

# *The Economic Imperative of Successful Health Care Reform*

Christina D. Romer  
Chair, Council of Economic Advisers

Statement before the Committee on the Education and Labor  
of the U.S. House of Representatives  
June 23, 2009

Chairman Miller, Ranking Member Kline, members of the Committee, it is an honor to be with you today to discuss the economics of health care reform. The President has identified comprehensive health care reform as a top priority. The Administration is grateful to the Congress for working so quickly and tirelessly on this important issue. In my remarks today I will discuss the economic imperative of health care reform that satisfies the President's dual goals of slowing the growth rate of health care costs significantly and providing quality, affordable health insurance coverage for all Americans.

I will first discuss the obvious, but sometimes forgotten point that the status quo is not an option. The projections for health care spending and what it means for households and the government budget show that we are on an unsustainable path. Without reform that slows the growth rate of costs, take-home pay for working families will stagnate and the budget deficit will mushroom. The projections for insurance coverage show that small employers are likely to reduce health insurance coverage substantially, leading to a swelling of the number of people without insurance in the United States over the coming decades.

I will then discuss the economic impact of coverage expansion and the importance of cost containment. A study released by the Council of Economic Advisers (CEA) on June 2, 2009 estimated the benefits to society and the economy of expanding coverage.<sup>1</sup> Our study found that coverage expansion has crucial positive effects on overall economic well-being, the efficiency of

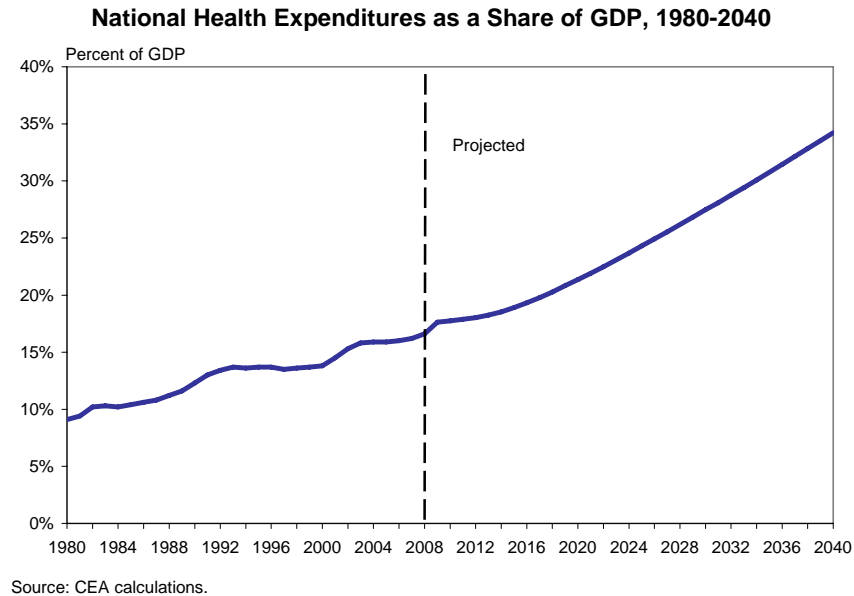
the labor market, and the competitiveness of the crucial small businesses sector. The CEA study also showed that successful cost growth containment was essential to the long-run health of our economy. I cannot emphasize enough the need to make meaningful changes that will genuinely slow the growth rate of health care costs. Only by doing so will we be able to avoid the dire long-term projections of stagnating living standards and crushing budget deficits.

The figures and analysis that underlie my testimony today are contained in the CEA report *The Economic Case for Health Care Reform*. With your permission, I would like to include a copy of that report with my testimony, so that the sources and methodology are fully documented for the Committee.

#### **I. TRENDS IN THE ABSENCE OF REFORM**

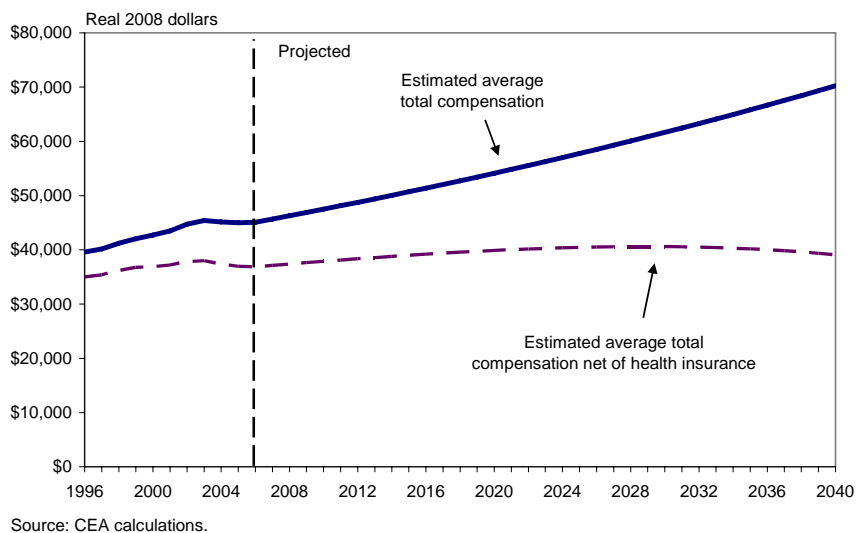
Let me start with a discussion of where we are and where we are headed. Many of the crucial economic trends in American health care are well known. But, the Council of Economic Advisers worked with others in the Administration to develop projections of what will happen in the absence of reform. Spelling out these facts and trends makes a compelling case that doing nothing is simply not an option.

**Rising Health Expenditures.** One key fact 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. This figure shows our projection of the likely path of national health care expenditures. By 2040, health expenditures could be roughly one-third of total output in the U.S. economy.



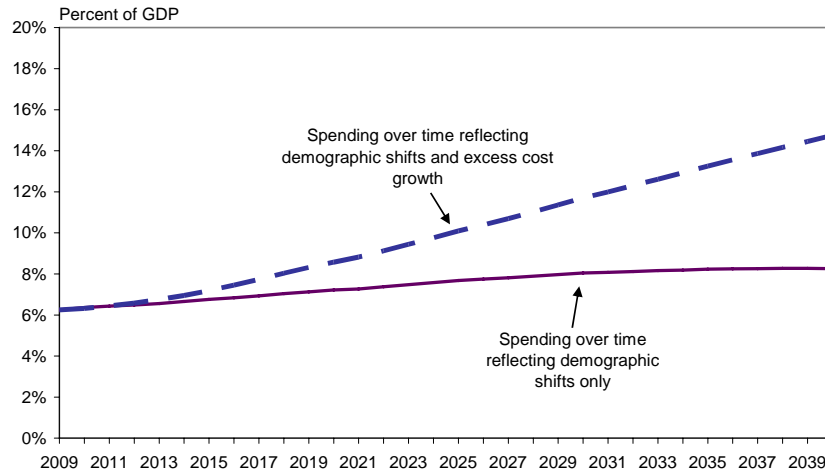
**Effect on Households.** For households, rising health care expenditures will likely show up in rising insurance premiums. Even if employers continue to pay the lion's share of premiums, both economic theory and empirical evidence suggest that this trend will show up in stagnating take-home wages for American working families. This figure shows our projection of total compensation and compensation less insurance costs, both in inflation-adjusted dollars. The wedge-shaped area between the two lines shows our predicted level of insurance premiums, again in constant dollars. We project that without reform, the non-insurance part of compensation will grow very slowly, and likely fall eventually, as premiums rise sharply over time.

### Projected Annual Total Compensation and Health Insurance Premiums



**Effect on Government.** Rapidly rising health care costs also mean that government spending on Medicare and Medicaid will rise sharply over time. The dashed line in this figure shows the projected path of combined Federal and state spending on Medicare and Medicaid. Our projections show that these expenditures, which are currently about 6 percent of GDP, will rise to 15 percent of GDP by 2040. The solid line shows the projected rise in Medicare and Medicaid expenditures due only to demographic factors, such as the aging of the baby-boom generation. A crucial fact is that only about one-quarter of the total projected rise in government health expenditures is due to demographic changes. The other three-quarters is due to the fact that health care spending per enrollee is rising much more rapidly than GDP. 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.

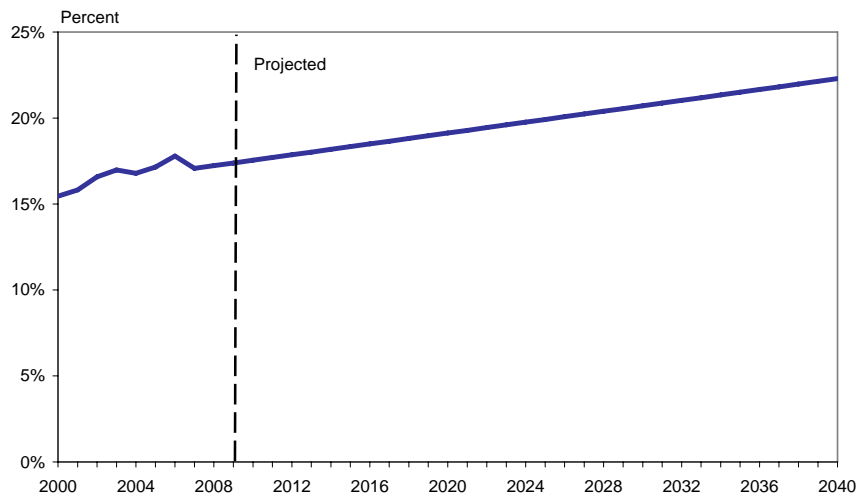
**Projections of Total Spending on Medicare and Medicaid as a Share of GDP, 2009-2040**



Source: CEA calculations.  
 Note: Total spending includes both Federal and state expenditures.

**Trends in Lack of Insurance.** Another trend that is 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, an increase of 26 million people over the next thirty years.

**Projected Percentage of the U.S. Population Under Age 65 without Health Insurance, 2000-2040**



Source: CEA projections using U.S. Census Bureau's Annual Social and Economic (ASEC) Supplement.

## **II. THE ECONOMIC IMPACT OF COVERAGE EXPANSION**

The President has emphasized that providing quality, affordable health insurance coverage for all Americans is a key goal of reform. For the many Americans who currently have health insurance, the President has said that if you like your doctor and your existing plan, you can keep them. He is committed to maintaining and building upon the employer-based health care system. The President and Congress are also proposing methods to make the existing system work better for all families, such as administrative simplification of insurance forms and electronic health records that reduce duplication of tests and prevent medical errors.

**Needed Reforms.** For the millions of Americans without insurance, the President is committed to working with Congress to design a sensible, cost-effective method of coverage expansion. A crucial challenge of coverage expansion is designing mechanisms that overcome market failures. For example, the fact that individuals know more about their likely health expenditures than potential insurers leads insurers to charge rates for individual and small group coverage that are above the average cost of providing coverage for these segments in the population. Expanding coverage will likely involve the creation of a health insurance exchange that gives individuals and small groups the same benefits of risk-pooling and elimination of adverse selection that employees of large firms enjoy.

One feature of health reform that the President has emphasized is that no one should be denied health coverage due to pre-existing conditions. Americans with health problems need the security of knowing that if they change jobs or lose their job, they will still be able to get health insurance coverage.

**Effects on Economic Well-Being.** There are important benefits to the economy and society of coverage expansion. The most important of these involves the health and economic

well-being of the uninsured. In our report, we use the best available estimates to try to quantify the costs and benefits of expanding coverage to all Americans. Among the benefits we attempt to put a dollar value on are the increase in life expectancy and the improvement in health. Evidence from the health economics literature suggests that if all of the uninsured had health insurance, there would be many fewer deaths among adults with chronic conditions, such as cancer and hypertension, and with acute conditions, such as heart attacks and injuries resulting from automobile accidents. Indeed, a 2002 study by the Institute of Medicine estimated that there are approximately 18,000 more deaths among uninsured adults each year than would occur if they had health insurance.<sup>2</sup> We also consider the benefit of health insurance as a way to reduce individuals' chance of financial ruin from high medical bills.

The costs to society of covering the uninsured represent a mix of public and private costs and come from existing studies, not estimates of plans currently being contemplated by Congress. We find the benefits of coverage to the uninsured are very large and substantially greater than the costs. Our estimates show that the net benefits—the benefits minus the costs—are roughly \$100 billion per year, or about 2/3 of a percent of GDP.

**Effects on Labor Supply.** Another effect of expanding coverage that we consider is increased labor supply. With full health insurance coverage, some people who would not be able to work because of disability would be able to get health care that prevents or effectively treats the 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.

**Effects on the Efficiency of the Labor Market.** A third impact that we identify is the effect of expanding coverage on the efficiency of the labor market. Expanding coverage and eliminating restrictions on pre-existing conditions would end the phenomenon of “job lock,” where worries about health insurance cause workers to stay in their jobs even when ones that pay more or are a better match are available. Our estimates, based on a range of economic studies, are that this benefit could be about 2/10 of a percent of GDP each year. Similarly, we examine the fact that small businesses are disadvantaged in the labor market because current employer-sponsored insurance is so expensive for them (due in large part to the fact that they do not have a large workforce over which to pool risk). Moving to an insurance system that removes this disadvantage should be beneficial to the competitiveness of the important small business sector of the economy.

### **III. THE CRUCIAL IMPACT OF SLOWING THE GROWTH RATE OF HEALTH CARE COSTS**

While the benefits of coverage expansion are substantial, slowing the growth rate of health care costs is essential to achieving some of the fundamental benefits of health care reform. As discussed previously, the U.S. health care system is on an unsustainable path. Successful cost growth containment is central to changing that path and securing a better economic future for the American people.

**Needed Reforms.** In discussing cost containment, I want to focus on slowing the growth rate of costs. This is the so-called “curve-bending” that can last for decades. Slowing the growth rate of costs is quite separate from actions that we might take immediately to cut the level



of government medical spending, such as the more than \$300 billion of Medicare and Medicaid savings proposed in our budget and the roughly \$313 billion of additional savings the Administration proposed two weeks ago.<sup>3</sup> These immediate reductions are unquestionably important for paying for the expansion of coverage and other health care reforms in the short run. Indeed, the President has frequently emphasized that health care reform must not add to the deficit in the next decade. But, for thinking about the changes that will save us from the unsustainable long-run trends I discussed earlier, slowing cost growth year after year is essential, and what we focus on in our study.

Of course, coverage expansion is likely to make some types of cost growth containment possible. For example, with coverage, individuals have improved access to primary care and may be more likely to receive education about disease prevention and management of chronic conditions. Smoking cessation and weight management are two preventative measures that could reduce cost growth over time, while improving health and quality of life.

Many other meaningful reforms are necessary to slow the growth rate of costs over time. The CEA report focused on the conceptual importance of reforms, rather than the mechanics. But the report does describe in broad terms the kind of changes that might be implemented. For example, we discuss changes in payments systems, such as bundling of payments for hospital and post-hospital care. We also discuss changes in the organization of care delivery, such as the formation of accountable care organizations and medical homes, as ways to reduce fragmentation and promote more effective and more efficient care. We emphasize the crucial role that investments in health information technology and research on what works and what doesn't could play in reining in cost growth over time. The President, in his speech last week to the American Medical Association, made some specific suggestions for reform along these

lines.<sup>4</sup> He also said that he was open to changes that would give the recommendations of the Medicare Payment Advisory Commission greater chance of adoption and implementation. The Congressional Budget Office has also outlined a large number of “game changing” reforms that experts believe would slow cost growth.<sup>5</sup>

**Evidence that Slowing Cost Growth is Possible.** The CEA report also surveys the evidence, much of it from international comparisons and comparisons across different parts of the United States, that there is substantial inefficiency in the current system. The finding of this survey is that up to 30 percent of health expenditures in the United States (which is equivalent to about 5 percent of GDP) could be cut without affecting health care quality or outcomes. This is important in making the case that slowing the growth rate of costs by improving efficiency is 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 have exhausted the existing inefficiency.

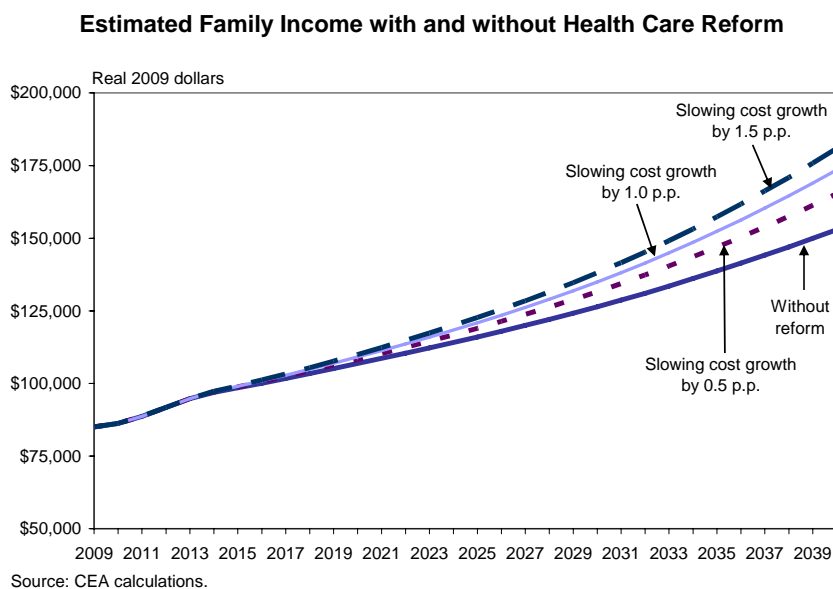
In our report, we speak of the benefits of slowing the growth rate of health care costs. But, each of our figures implicitly shows the impact of *not* slowing the growth rate of costs. To help emphasize the importance of doing reform well, I will describe them from that perspective this morning.

**Effect on Living Standards.** Fundamentally, what slowing cost growth does is 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 other things that we value. This causes standards of living to be higher with a slower growth rate of health care costs. In our analysis, we consider varying degrees of cost containment. In particular, we look at the effects of slowing the annual growth rate of health care costs by 1.5, 1.0, and 0.5 percentage points. To be

conservative, we assume that it takes a few years for genuine curve-bending to kick in.

We analyze the effects of this freeing up of resources in a standard growth accounting framework. Our framework includes the effect of slowing cost growth on 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 deficit and thus raise public saving. And, efficiency gains that raise income would lead to some additional private saving. All of this increased saving would tend to lower interest rates and encourage investment. This extra investment increases output even more.

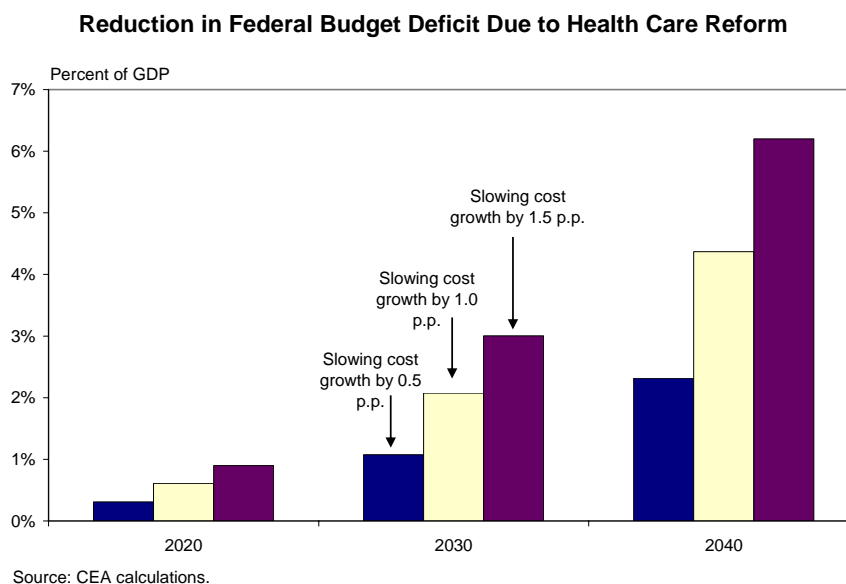
This figure shows the crucial importance of slowing cost growth for standards of living. To make these numbers more concrete, we translate them into the effects on the income of a typical family of four (in constant dollars). The bottom line shows the projected path of real family income without reform. The higher paths show family income under different degrees of cost containment.



Our numbers suggest that failing to slow cost growth results in substantially lower standards of living for American families. Without reform, our analysis predicts that typical family income in 2020 will be roughly \$2,600 lower than it would be if we managed to slow the growth rate of costs by 1.5 percentage points. By 2030, it will be nearly \$10,000 lower than if we managed to slow cost growth. Failing to control the growth rate of health care costs will condemn American families to much lower standards of living than they would experience with successful reform.

**Effect on the Budget Deficit.** I also want to discuss what our analysis implies about the effect of health care cost containment on the Federal budget deficit. I need to be very clear that our estimates are not official budget projections, which would be based on detailed projections of spending and revenues. Ours are more a back-of-the-envelope calculation. And, they do not include the costs of coverage expansion, because the President has suggested spending cuts and revenue increases that are expected to cover the additional costs in the next decade. Our numbers show the effect of slowing cost growth over the long term.

We find that the implications of slowing cost growth for the deficit are enormous. This figure shows the reduction in the Federal budget deficit due to different degrees of cost containment. Consider the numbers for 2030. They show that slowing the growth rate of health care costs by 1.5 percentage points will reduce the deficit by 3 percent of GDP relative to the case of no reform. Put another way, failing to slow the growth rate of health care costs by 1.5 percentage points per year will result in a deficit that is higher by 3 percent of GDP. By not slowing costs, we will leave our children a budget deficit in 2040 that is 6 percent of GDP higher than it would have been with successful reform. The numbers illustrate the crucial truth that serious health care cost growth containment is central to long-run fiscal stability.



**Effect on Short-Run Macroeconomic Performance.** Finally, by not slowing the growth rate of costs, we will also likely forego a period of better-than-average economic performance. 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. Our estimates suggest that slowing cost growth by 1.5 percentage points per year would lower normal unemployment by around  $\frac{1}{4}$  of a percentage point. This translates into an increase in employment of about 500,000 jobs. While this is almost surely not a permanent effect, it could last for a number of years.

Taken together, the analysis by the Council of Economic Advisers shows that doing nothing on health care is simply not an option. The country is on an unsustainable path. Expanding coverage will unquestionably have benefits for economic well-being, the efficiency of the labor market, and the competitiveness of small businesses. But, undertaking meaningful reforms to slow the growth rate of health care costs is absolutely essential. Only by doing so can we assure American families of rising living standards, and falling, rather than ever increasing, budget deficits.

The President has spoken frequently of the need to provide the American economy with “a new foundation.” His goal is that we not only come through the current economic crisis, but emerge a stronger, more durable economy. Health care reform that provides quality, affordable coverage for all Americans and genuinely slows the growth rate of costs significantly is a crucial part of that new foundation. Meaningful reform is fundamental to the long-run health of the American economy.

## **NOTES**

<sup>1</sup> Council of Economic Advisers, *The Economic Case for Health Care Reform*, June 2, 2009, <http://www.whitehouse.gov/administration/eop/cea/TheEconomicCaseforHealthCareReform/>

<sup>2</sup> Institute of Medicine. “Care Without Coverage: Too Little, Too Late.” May 2002. <http://www.iom.edu/CMS/3809/4660/4333.aspx>.

<sup>3</sup> Office of Management and Budget, Fiscal 2010 Budget Fact Sheet, Transforming and Modernizing America’s Health Care System, [http://www.whitehouse.gov/omb/fy2010\\_key\\_healthcare/](http://www.whitehouse.gov/omb/fy2010_key_healthcare/); and The White House, “Paying for Health Care Reform,” June 13, 2009, <http://www.whitehouse.gov/MedicareFactSheetFinal/>.

<sup>4</sup> The White House, “Remarks by the President at the Annual Conference of the American Medical Association, June 15, 2009, [http://www.whitehouse.gov/the\\_press\\_office/Remarks-by-the-President-to-the-Annual-Conference-of-the-American-Medical-Association/](http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-to-the-Annual-Conference-of-the-American-Medical-Association/)

<sup>5</sup> Congressional Budget Office, “Health Care Reform and the Federal Budget,” Letter to the Honorable Kent Conrad and the Honorable Judd Gregg, June 16, 2009, <http://www.cbo.gov/ftpdocs/103xx/doc10311/06-16-HealthReformAndFederalBudget.pdf>; and *Budget Options, Volume 1: Health Care*, December 2008, <http://www.cbo.gov/ftpdocs/99xx/doc9925/12-18-HealthOptions.pdf>.