

U.S. Health Care Reform: Some Implications

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The passage of landmark U.S. health care reforms will greatly expand coverage, albeit at a cost for taxpayers. The reforms represent the biggest overhaul of the \$2.5 trillion health care industry since the birth of Medicare in 1965. The main thrust is to provide more affordable (subsidized) insurance to lower-income workers and to expand coverage for the poor, while raising payroll taxes on the wealthy and penalizing companies that don't provide insurance to workers. This largely resolves the coverage problem, especially for those who can't afford insurance when they lose their job or become sick. However, many questions remain about whether the overhaul resolves the other major health care problem—spiralling costs. The expanded coverage will cost nearly \$1 trillion over the next decade and will put further strain on the industry. Most of the changes will not occur until 2014, so there are few near-term effects on the economy or monetary policy, though the added cost to business could lift inflation in the medium term.

The good news is that the reforms will:

- Expand coverage to 32 million uninsured Americans, or about 94% of legal U.S. residents by 2019, up from about 83% today. The U.S. currently is one of only three major OECD nations (the others are Mexico and Turkey) without universal health care coverage. About half of the newly insured are expected to use tax credits to purchase private insurance, while others would become eligible for Medicaid (the health program for the poor and disabled) starting in 2014.
- Provide tax subsidies to help lower-income workers buy insurance.
- Create an online insurance-purchasing exchange to allow people to compare plans and buy at lower group rates. The exchanges will improve regulatory oversight of insurance companies, which might result in lower costs and premiums.
- Prohibit insurance companies from charging customers more for pre-existing health problems when they lose their insurance coverage, or from putting lifetime caps on coverage.
- Provide small businesses with tax credits to help cover workers.
- Propose to reduce projected spending on Medicare (the health program for people over 65) by about half a trillion dollars in the next decade.

...and the relative winners are:

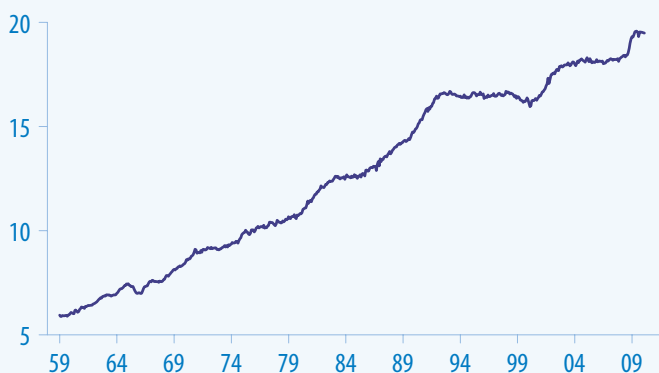
- Lower-income households with incomes up to 133% of the federal poverty level (about \$29,000 for a family of four), who will gain access to Medicaid.

- Employees of subsidized small businesses, who could see premium reductions.
- Workers in companies without insurance coverage and the self-employed, who will gain access to more affordable insurance options.
- Hospitals, private health care clinics and drug companies, who will benefit from millions of newly insured (and paying) customers. Hospitals will face fewer losses from current uninsured patients who can't pay their bills.
- Commercial landlords, who will benefit from increased demand for medical office space.
- Seniors, who will see an expansion of the Medicare drug benefit and, in some cases, a 50% discount on brand-name drugs.

The bad news is that the reforms will:

- Cost \$938 billion over ten years, according to the Congressional Budget Office. This means health care will absorb an even greater share of the economy; and, at 16% in 2007, the U.S. already stands well above the next country (France at 11%) and the OECD average (9%). Health care consumes almost one-fifth of American household spending, and the share is rising (*Chart 1*).
- Be financed largely through new taxes and fees rather than major reductions in drug or other health costs.
- Impose an extra 0.9% Medicare payroll tax on individuals earning more than \$200,000 a year and couples earning more than \$250,000 (starting in 2013), as well as a 3.8% Medicare excise tax on capital gains and unearned income such as interest, dividends and rents.
- Impose higher taxes on high-cost insurance plans (starting in 2018).

CHART 1
UNHEALTHY GROWTH IN SPENDING
 United States (% of total consumer spending)
 Household Spending on Health Care



- Impose new fees on insurers, which could result in higher premiums.
- Impose fines on companies with more than 50 employees if they don't provide coverage (starting in 2014) and on some people who don't have insurance.

The impact on the:

Economy: The bulk of the legislation (including the subsidies, the expansion of Medicaid coverage, and penalties on companies) won't take effect until 2014. This implies little near-term impact on growth, inflation or monetary policy. Over time, however, increased insurance coverage means more resources will be allocated to the

health care sector, which already accounts for one-sixth of the economy. Higher taxes and fees to pay for the expansion could reduce demand for other goods and services. Some companies might pass higher insurance costs along to consumers, lifting inflation if the economy is operating at full capacity. Smaller companies at risk of paying the non-insurance penalty might curb employment after extending work hours and outsourcing some work to other firms. Higher health care costs for companies could reduce U.S. competitiveness, especially against countries (like Canada) where corporate income taxes are falling. On the flip side, the reforms could support confidence and spending if current uninsured consumers feel more secure in their financial future. As well, labour mobility could improve if job leavers have more assurance that they won't lose affordable coverage.

Budget Deficit: Despite costing almost \$1 trillion over the next decade, the Congressional Budget Office projects the reforms will actually reduce the budget deficit by \$143 billion from 2010 to 2019 (though that's just 2% of the projected \$7 trillion in deficits over the period). The deficit reduction comes largely from slower growth in Medicare spending and increased Medicare payroll taxes on high-income earners along with new fees on insurers and drug makers. However, the planned reductions to Medicare spending may never materialize given increased demands from an aging population. Indeed, a former director for the CBO thinks the reforms will increase the budget deficit by over \$500 billion in the next decade.

Health Care Quality: Increased demand for health care services might exacerbate the doctor shortage and place greater strain on the system. Much will depend on the supply response. The country currently faces a shortage of more than 100,000 doctors in the next 15 years, and only 27,000 new physicians are trained each year, according to the Association of American Medical Colleges. Potentially, this could worsen the doctor shortage in Canada, if the U.S. aggressively recruits from north of the border.

Health Insurers: It's unclear how insurance companies will fare. Despite gaining millions of new subsidized customers, insurers will need to take on clients with existing health problems, cover the full cost of preventive care, pay higher fees, and face greater oversight of premium increases. Consolidation in the insurance industry is possible if smaller players can't compete under the new rules.

Corporate Writedowns: A number of American companies have recently announced big charges against earnings (notably a \$1 billion hit to AT&T) because of a tax change that will prevent firms from deducting government subsidies for providing drug benefits to retired workers. The change will result in a higher future tax bill for some companies, but the charges are non-cash and represent a one-time hit to earnings.

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