As Reinhardt notes, the total size of the U.S. public sector (measured by tax revenue) has been remarkably fixed over the past two decades, at about one-third of total economic output. The antitax sentiments of the citizenry have created a climate in which significant expansion of the public sector is very unlikely. The size of the public pie is effectively fixed. As a result, Reinhardt argues, Medicare and Medicaid expenditures that are escalating more rapidly than the growth of the economy as a whole threaten to “mortgage our nation’s future competitiveness” by precluding necessary public investment in human capital formation (education) and in the rebuilding of our deteriorating infrastructure.

If the bulk of health care were financed through the public sector, as in Canada, paying for the yearly growth would virtually preclude any other significant investments by government. In Ontario, Canada’s largest province, for example, health spending in the past ten years has grown from 28 percent to 33 percent of provincial spending. Social services, which include long-term care, have grown from 11 percent to 16 percent. In contrast, education spending has shrunk from 16 percent to 11 percent of the provincial budget, and spending on research and economic development has dropped from 19 percent to 15 percent. Since Canadians are significantly more committed to and supportive of government social welfare spending than Americans, putting more of health financing onto the U.S. public budget would likely have a greater negative impact on nonhealth domestic spending here than in Canada. The long-run consequences for economic productivity could be severe.

In sum, nationalizing the financing of health care offers no certainty that costs will be controlled and is likely to jeopardize our nation’s future competitiveness. The logical conclusion is that we need innovative and effective private-sector efforts to attack the cost problem.

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4. Ibid.

Competitiveness And Excellence: Health Costs And U.S. Business

by Samuel A. Mitchell

Uwe Reinhardt’s essay once again demonstrates the truth of the proposition that what everybody knows usually is wrong. The popular litany is that the United States is becoming less and less competitive in global markets. Declining competitiveness is bad because it leads to loss of market share, fewer jobs, slower growth in real per capita income, greater dependence on foreigners for products critical to our future industrial strength (such as microchips), and so on. Higher U.S. spending on health care is a recent addition to the usual list of suspects: unfair foreign trade practices, higher capital costs, and lower labor costs abroad.

Very few commentators have been so impolite as to mention that most of our alleged competitive disadvantages are self-inflicted and can be corrected by those doing most of the complaining. Interest rates would be lower and American exports would benefit from a lower dollar if Americans accepted the brute fact that they cannot simultaneously demand more services from government and keep taxes constant as a share of gross national product. American corporations would increase market share if they made more products that offered better...
value. The people who worry most about competitiveness are the same ones whose houses and garages are disproportionately full of Japanese products because they know superior value when they see it.

The principle that "the fault, dear Brutus, is not in our stars, but in ourselves" applies equally well to employer health care costs. As Reinhardt shows, in globally competitive product and financial markets, managements over the long run cannot shift high health care costs either to consumers via higher prices or to shareholders via lower profits. Consequently, the main impact is not impaired competitiveness, that is, the ability to be price- and quality-competitive. Instead, total compensation, which ultimately determines competitiveness, is not changed by high health care spending; all that happens is that health care absorbs a greater proportion of total compensation.

Reinhardt also points out that some large corporations in mature industries (autos, steel) in past years have promised employees lavish postretirement health benefits but have forgotten to tell shareholders what their sweetheart deal—deferred compensation in return for labor peace—would cost. These prior promises do impose a burden on companies relative to their overseas competitors by reducing the present value of their future free cash flow. But it does not follow that consumers, taxpayers, or even those spending-crazy doctors and hospitals should bear the consequences of bad decisions by big business. The costs are properly borne by a firm’s owners (shareholders) and by management. The stock market has already marked down the value of the shares of companies with large unfunded retiree health benefits. The managers responsible for these decisions as usual got off Scot-free; they are retired and living well in Palm Springs.

Reinhardt’s most original and important point is that high health care expenditures may affect America’s competitiveness mainly because such a high proportion of health care (40 percent) is financed through public budgets. His logic is that Americans want more of the services government pays for but do not want to pay more taxes. Thus, increased public spending on health care crowds out other publicly financed activities (education, public works), which have a direct, major, and lasting impact on U.S. competitiveness.

Some Corollaries

Reinhardt’s propositions, which I find compelling, suggest some fascinating corollaries.

Public spending. Competitiveness is likely to suffer if an increasing share of health care spending is financed through public budgets. A small but growing minority of corporations—the same ones that are most vocal about the alleged adverse effects of health spending on competitiveness—are calling for a Canadian-style health care system in which government is the sole payer and controls costs through expenditure caps for physicians and global budgets for hospitals. This approach is in the grand tradition of businesses asking government to control their costs for them (but do not touch pricing and be sure to be ready with a bailout or at least some import quotas to protect against foreign competition).

Increasing the share of health services financed by taxes and/or government debt will once again validate the law of unintended consequences and have the opposite effect of what is intended. Demand for health care will remain unconstrained, and as a result of the U.S. political system in which power is highly fragmented, particularistic interests will prevail over the general interest until severe financial problems can no longer be ducked. Specifically, the combination of senior citizens wanting more benefits, providers wanting more money to meet increasing demand for expensive new technology, and politicians wanting to avoid saying “no” almost guarantees that publicly financed health spending would crowd out other publicly financed activities that enhance competitiveness.

Cost containment. Since product and capital markets do not tolerate fiscally irresponsible corporate behavior for very long, logic would suggest that successful health care cost containment requires that respon-
sibility for containing costs remain in private hands to the maximum extent feasible. Corporations have to balance the immediate effects of higher health costs against the long-term contentment of their employees. Thus, they face precisely the right set of incentives for stimulating a continuous, much-improved effort to allocate scarce resources to their highest-valued uses. Perhaps the best way to stimulate a pattern of health spending that produces better health care value for the dollar is to strengthen the right incentives. The federal government has two very powerful ways of accomplishing this: reduce trade barriers further and get rid of the $40 billion-plus, highly regressive tax subsidy that occurs when employer-paid health insurance is tax-free to the employee.

Corporate Accountability

Corporations advocating greater public financing of health care often argue that they have done everything possible to contain their payments for employee health care, but they just cannot make progress. A more accurate statement is that most companies have not been ready to do what was necessary. They have been afraid of upsetting their unions or their nonunionized workers.

Rhetoric aside, the facts suggest that while there has been some nibbling at the edges of the problem, employee and provider incentives have not been subjected to the fundamental restructuring necessary to improve value. Large employers’ coverage for vision, dental care, and prescription drugs has increased in recent years; employees have few incentives to enroll in low-cost health plans; and the financial incentives for employees to use providers selected by their employer tend to be weak. Consequently, most employers have found it difficult to make full use of their bargaining power in negotiating with doctors and hospitals.

Each of these difficulties can be largely overcome by applying to health plan redesign the principles long advocated by Alain Enthoven. But the business community so far has been reluctant to embrace major restructuring of health plans, perhaps because a soundly designed plan would put the burden squarely on employees to make tradeoffs between cost and scope of coverage. To this reluctance, I say that, over the long run, individual employees with the help of their employers will make better resource allocation decisions than would be made under global budgeting and expenditure caps. In increasingly tight labor markets, excellence in health plan management could give heads-up companies a significant competitive advantage in attracting the best workers.

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A ‘Real-World’ Economics Lesson For American Business

by Merlin K. DuVal

For some time now, American business has claimed that escalating employee health care costs are holding it hostage in its ability to compete equitably in the international arena. Uwe Reinhardt argues that it is time this myth was dispelled. While he draws on sound economic theory to do so, I do not think he quite makes the case, because the cost of labor—whether cash or benefits—translates directly into higher product prices. What he has done, however (and it may be even more important), is draw our attention to the impact American business