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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.

**NOTES**


**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
has had on our health care delivery system and its costs.  

**Background.** Let me be more specific. Most of American businesses' current difficulty with escalating health care costs can be attributed to decisions these same businesses made earlier. For instance, during World War II, the War Powers Act of 1942 effectively froze all U.S. wages and salaries. This had the effect of shifting labor's negotiations with management from cash compensation to benefits. Shortly thereafter, benefits were construed as interchangeable with, and the equivalent of, cash compensation by the Seventh U.S. Circuit Court of Appeals in the case of Inland Steel vs. the National Labor Relations Board in 1948. This was subsequently reaffirmed by the U.S. Supreme Court. Thus, Reinhardt's invocation of economic theory regarding the interchangeability of cash compensation and benefits as determinants of the market-clearing price has roots in the real world. It strengthens his argument that singling out health benefits as destructive to international competition over price misses the larger point.  

The situation was aggravated in 1952, when the Internal Revenue Service codified its treatment of benefits as a cost of doing business to the employer and as tax-free to the employee. This was followed by a progressive increase in the degree to which American business made high first-dollar coverage available for health benefits, thereby making medical care available to the great majority of America's work force at no cost to itself. Once this social good became, for all practical purposes, free to the employee, it did not take long for that employee to treat health care as an entitlement.  

American business then further aggravated its own situation by offering to extend those benefits beyond its own employees by encompassing dependents and retirees. Indeed, when queried recently, a spokesman for one of America's largest automobile manufacturers acknowledged that 60 percent of his company's annual health care expenditures were made on behalf of persons who do not currently work for that company or never have. In this context, Reinhardt's point that American business does not sound particularly credible when it blames its lack of international competitiveness on the cost of health care is especially valid.  

**Future developments.** Reinhardt may have done us an even greater favor by suggesting what the future may hold. I refer here to his vision that a concatenation of two events may radically reshape traditional American thinking. The first of these is that the federal government has continued to promise increased health benefits to its beneficiaries while, at the same time, responding favorably to the cry from the American public not to increase taxes. It accomplishes this by progressively transferring the cost of those benefits to the private sector. Worse, it underpays America's providers and practitioners who, of necessity, must then transfer their costs of doing business to the private, paying sector—most of which is American business. Eventually, American business must rebel; this rebellion will create tremendous pressure on the public sector to "nationalize the private agony."  

At approximately the same time, the newly proposed accounting rules of the Financial Accounting Standards Board (FASB) will require employers to report the estimated future costs of their postretirement health benefits on an accrued basis. The magnitude of this liability on their books will make their contemporary health care expenditures seem almost trivial. If they wish to remain competitive when that occurs, the pressure to "nationalize the private agony" may become too great to bear.  

Our first major private business bailout came just a few years ago, when Chrysler asked to be bailed out by the federal government well before health care costs were the issue. More recently, as Reinhardt correctly warns, if we can now commit $200 billion to bail out our ailing savings and loans, it could become very difficult for government to resist the pressure of American business when it seeks relief to remain competitive in the international arena.