

# EFFECTS OF HEALTH CARE SPENDING ON THE U.S. ECONOMY

## EXECUTIVE SUMMARY

This background paper examines health care spending and the impact on the economy of the United States. In brief, the findings reported in this paper are:

- The relationship between health care spending growth and the U.S. economy is inherently complex and multidimensional. Rising health care spending can be viewed as both a weight on broader economic growth and as a driver of sectoral and local prosperity.
- RECENT TRENDS – Since the late 1990's, health care spending has increased at a faster rate of growth than has gross domestic product (GDP), inflation, and population. In the latest year data are available (2003), total national spending on health care rose to \$1.7 trillion, or \$5,670 per person.
- OVERALL ECONOMY – Rapidly rising health care spending is considered to lower the rate of growth in GDP and overall employment, while raising inflation. However, some economists view increases in health care spending as a neutral, if not positive, impact on the economy. Increased health care spending, in this view, is seen as improving access to new health care technologies and treatments.
- EMPLOYERS – 174 million Americans, or 60.4 percent of the population, had employment-based health insurance during 2003. A December 2004 survey of CEOs found that employee health care costs are the foremost cost concern in the minds of America's business leaders
  - ACTIVE WORKERS – In 2004, employers contributed \$3,137 for single coverage and \$7,289 for family coverage on average across all plan types.
  - RETIREES – The 2004 Kaiser/Hewitt survey on retiree health benefits found that the total cost of providing health benefits to retirees from 2003 to 2004 increased by 12.7 percent, on average, for surveyed employers.
  - LOCAL IMPACTS, HEALTH SECTOR – The health sector is a significant source of employment for American workers, employing 6.3 million practitioners and technical workers, and 3.2 million Americans in health care support occupations as of November, 2003.
- EMPLOYEES – Workers with employer-sponsored health insurance will often experience reductions in real (after adjusting for inflation) wages (or wage growth) in response to health care cost growth. The empirical evidence has tended to show that health care cost increases are offset by either direct wage reductions, increased employee cost sharing, or in instances where wages are fixed (i.e., unionized contracts), by increases in the number of hours worked.
- HOUSEHOLDS – In the latest available data (2002), the average household spent \$2,350 a year, or 4.8 percent of its income, on health care. Roughly 20 million American families, or 43 million people, reported financial problems related to paying medical bills in 2003.

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### INTRODUCTION

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In recent years, considerable attention has focused on aggregate health care spending increases. Emphasis has been given to identifying and examining the factors that have contributed to spending growth, and proposing policy solutions to reduce spending growth. Factors that contribute to spending growth encompass changes in health care utilization, population demographics, price inflation, and advances in medical technology.<sup>1</sup>

This background paper focuses on a somewhat broader topic—how health care spending impacts the economy of the United States. The relationship between health care spending growth and the U.S. economy is inherently complex and multidimensional.

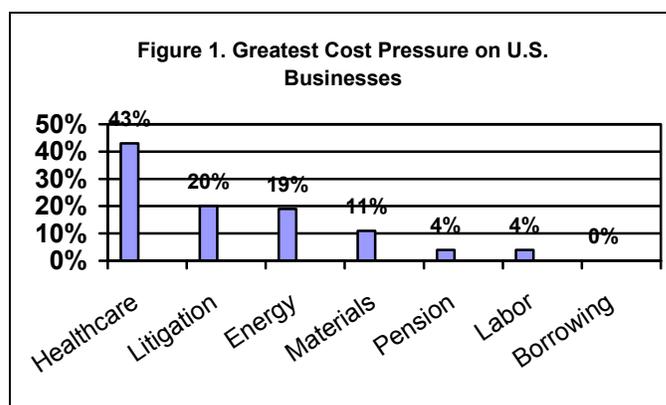
At an aggregate level, economists have cautioned that rising health care spending could lower economic growth and employment.<sup>2</sup> A December 2004 survey of CEOs found that employee health care costs are the foremost cost concern in the minds of America's business leaders (Figure 1).<sup>3</sup> Further, rising health care spending has a significant impact on the federal budget.<sup>4</sup> Many employers are seeking to limit their exposure to rising health care costs by requiring their employees to increase their contributions or by providing different forms of coverage, potentially reducing household available income as more costs are shifted from employers to employees.

Some economists note that rising health care spending has important benefits, often outweighing the increased costs.<sup>5</sup> When adjusted for improvements in quality, these economists found that the value of medical care is in fact increasing. In this view, increased health care spending improves access to new technologies—providing both new options of

treatment (substitution) and treatment for a greater number of individuals (expansion).

“Technology often leads to more spending, but outcomes improve by even more.”<sup>6</sup>

At a local level, health care spending growth is more likely to be viewed as beneficial. It creates health care jobs, increases wages for health care workers, expands local tax revenues, and increases demand for related goods and services.



Source: Business Roundtable December 2004 CEO Survey.

The remainder of this paper is organized into five sections. The next section contains a brief overview of trends in health care spending. This is followed by four sections that contain discussions of the impacts of health care spending on 1) the overall economy, 2) employers, 3) employees, and 4) households.

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### TRENDS IN HEALTH CARE SPENDING

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#### *Total Spending*

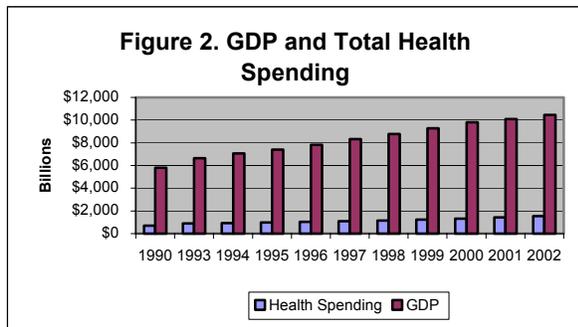
In the latest year for which data is available (2003) total national spending on health rose to \$1.7 trillion, or \$5,670 per person (Table 1). By 2013, national health expenditures are projected to reach \$3.4 trillion, or \$10,709 per person. As a share of GDP, health spending is

projected to reach 18.4 percent by 2013, up from its 2003 level of 15.3 percent.

	1960	1985	2003
Total	\$27 billion	\$427 billion	\$1,678.9 billion
Per capita	\$143	\$1,765	\$5,670
Share of GDP	5.1%	10.1%	15.3%

Source: National Health Expenditures, Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group; U.S. Department of Commerce, Bureau of Economic Analysis; and U.S. Bureau of the Census.

Spending on outpatient hospital services and prescription drugs continued to outpace the rate of growth in overall health care spending as services move out of the hospital and into ambulatory settings. Since 1998, health care spending has increased at faster rate of growth than has gross domestic product (GDP), inflation, and population.<sup>7</sup>



Data Source: National Health Expenditures 2002. Centers for Medicare & Medicaid Services. NHE Tables.

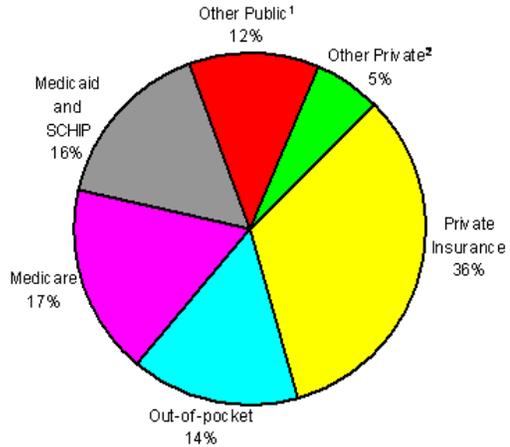
Although the recently passed Medicare prescription drug benefit is not expected to have a large impact on overall national health spending, it is expected to cause sizable shifts in payment sources.<sup>8</sup> These shifts include from individuals and private payers to Medicare and from Medicaid to Medicare.

### Sectoral Spending

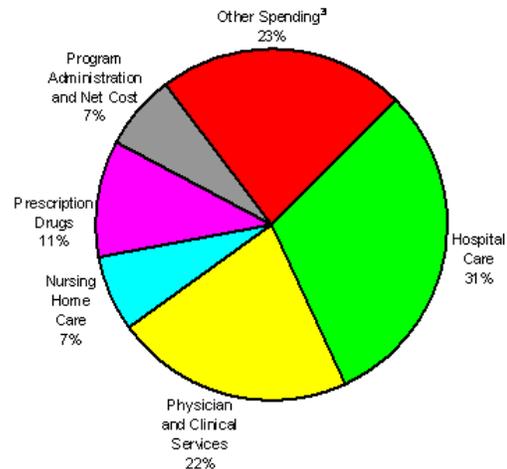
In 2003, the private sector accounted for over half of national health expenditures, with private health insurance contributing the largest share (\$600.6 billion or 36 percent) (Figure 3). Individual out-of-pocket payments, part of

private sector spending, accounted for \$230.5 billion (or 14 percent of expenditures) in 2003.

**Figure 3. The Nation's Health Dollar Sources of Funding**



**Uses of Funding**



1 "Other Public" includes programs such as workers' compensation, public health activity, Department of Defense, Department of Veterans Affairs, Indian Health Service, and State and local hospital subsidies and school health.

2 "Other Private" includes industrial in-plant, privately funded construction, and non-patient revenues, including philanthropy.

3 "Other Spending" includes dental services, other professional services, home health care, durable medical products, over-the-counter medicines and sundries, public health activities, research and construction.

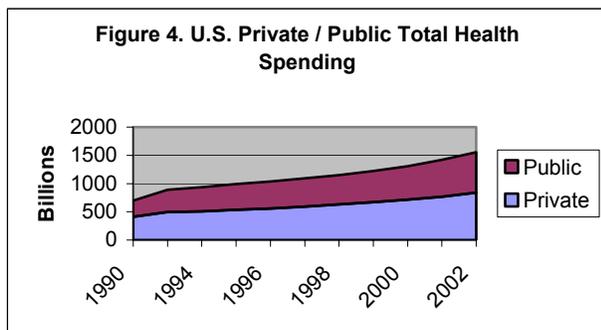
Graphic Source: *Charts, National Health Expenditures 2003*. Centers for Medicare & Medicaid Services.

Over half of the recent increase in out-of-pocket spending for health services was due to increases in spending for prescriptions drugs, reflecting new medicines, greater utilization,

price increases, and the fact that seniors--the age group that uses the most prescription drugs--often pay 100% out-of-pocket today.

The public sector accounted for the remaining 46 percent of total health spending. The Medicaid and Medicare programs accounted for 16 percent (\$267.0 billion) and 17 percent (\$283.1 billion), respectively. Other government health spending on public health, veterans, military personnel, and school children comprised most of the remaining 12 percent of public sector health spending.<sup>9</sup>

Finally, the public's share of health spending has steadily increased. In 1990, public spending accounted for about 41 percent of total spending (Figure 4). By 2002, the public's share had increased to 46 percent of total spending.



Data Source: National Health Expenditures 2002. Centers for Medicare & Medicaid Services. NHE Tables.

## EFFECTS OF HEALTH CARE SPENDING— OVERALL ECONOMY

The gap between the growth in health care spending of 9.3 percent and overall economic growth of 3.6 percent, which means a larger share of resources are being devoted to health care relative to other goods, will impact the public and private sectors of the economy.<sup>10</sup> The public sector – federal, state and municipal governments – is faced with costs rising more rapidly than revenues, placing high scrutiny on all discretionary spending, especially health care. Companies with rising health care

spending may cut other expenses, reduce wage increases, reduce health insurance benefits, or require employees to pay a greater share of the costs. As more costs are shifted to consumers, they will weigh the value of health care services will be more closely against other purchases.

Some economists believe that rapidly rising health care spending lowers GDP and overall employment, while raising inflation. The effects of health care spending on interest rates and the relative impact on economic performance across industries depend upon the source of financing for federal health care spending. The results of one study using econometric models indicated that deficit financing disproportionately harms export and capital goods industries, and payroll tax financing disproportionately harms consumer service industries.<sup>11</sup>

It should be noted, however, that some economists view increases in health care spending as a neutral, if not positive, impact on the economy. Increased health care spending, in this view, is seen as a transfer.

*“One American’s rising medical spending is another American’s rising income.”<sup>12</sup>*

These transfers result in real employment growth and financial prosperity for companies that are largely American owned. The Congressional Budget Office (CBO) notes in a related viewpoint that as income rises, consumers may choose to assign a larger portion of their resources to health care services and a smaller portion to other goods and services.

### Government Spending

Rising healthcare spending plays a central role in the fiscal health of the United States government.

In 1960, public funding accounted for about 25 percent of total health care spending. By 2002, this share nearly doubled to approximately 46 percent of total spending.<sup>13</sup> A large part of this increase is attributable to the introduction of the Medicare and Medicaid programs together with the aging of the population and expansion of program eligibility and benefits.

The primary impact of the increase in the government's share of health care spending is the burden it places upon the citizens to finance this spending—namely increasing taxes, or increasing long-term borrowing. In addition to reducing the amount of income that firms and households would have for other activities, tax increases also create incentives to engage in activities to avoid the effects of these increases.<sup>14</sup>

Increased government borrowing to finance health care spending growth has a similar impact on the availability of resources for other activities. As interest rates increase due to government borrowing, the cost of capital to firms and households also increases, which would effectively “crowd out” investment in some activities that would otherwise been undertaken.

Finally, increased spending often results in greater intergenerational transfers of wealth from younger to older segments of the population.<sup>15</sup>

### ***International Competitiveness***

In theory, increasing health care costs could make U.S. goods and services less competitive in international markets.<sup>16</sup> Holding all other factors constant, increasing health care costs will have to be reflected in the final product costs, and depending upon how quickly health care costs are rising in other countries, could result in relatively more expensive goods and services.

Obtaining quantitative estimates of the degree to which health care costs have contributed to the US trade deficit (or other measures of interest), however, is a complex undertaking. According to statistics from the Organisation for Economic Cooperation and Development (OECD), health care costs accounted for about 15 percent of US GDP in 2002. In contrast, for Switzerland (the next highest country) and the Slovak Republic (the lowest country in the comparison group) health care costs accounted for about 11 percent and 6 percent of GDP, respectively.<sup>17</sup> Although these simple statistics illustrate a sharp contrast across countries, converting these differences into relative product/service prices would entail accounting for differences in worker productivity, health care's share of total production costs, technology, and other factors that affect relative product prices between different countries.

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### **EFFECTS OF HEALTH CARE SPENDING—EMPLOYERS**

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Many Americans receive part or all of their health insurance coverage through their employer during their years of active work and in retirement (174 million Americans, or 60.4 percent of the population, had employment-based health insurance during 2003).<sup>18</sup> In 2003, U.S. private employers spent an estimated \$330.9 billion on employee health insurance.<sup>19</sup> Adjusting for participation in health insurance coverage by employers, it has been estimated that those who offered health insurance spent an average of \$3.80 per hour for participating employees in 2003.<sup>20</sup>

Some employers now view rising health care costs as equally important to their profitability as energy costs and broader economic trends.<sup>21,22</sup> Employers from large airlines to restaurant chains report double-digit increases in their health care spending, which potentially erodes profits. Growth in health care spending has led employers to reduce, eliminate, or change this coverage.

Rising health care spending has the potential to lead some employers to curtail new hiring of full-time, benefit-eligible, employees. These increasing costs may also force companies – perhaps most notably automakers with their large pool of unionized retirees – to raise prices for their products. General Motors estimated in 2004 that providing health insurance for its workers and retirees added \$1,400 to the price of cars built in the United States.<sup>23</sup>

### ***Active Worker Coverage***

Employers have seen their costs to insure active workers and dependents rise. In 2004, public and private employers surveyed by Kaiser/HRET contributed \$3,137 for single coverage and \$7,289 for family coverage on average across all plan types.<sup>24</sup> These costs have led to a small though statistically significant drop in the number of employers who offer health insurance to their active workers and dependents since 2001 (a decrease from 68 percent to 63 percent of all firms). A majority of employers in 2004 reported that they are likely to increase the amount that employees pay for health insurance.

### ***Retiree Coverage***

From 2003 to 2004, larger private sector employers providing retiree health insurance coverage saw their costs increase by an average of 12.7 percent.<sup>25</sup> As a consequence of these rising costs, a recent survey found that during the past year 79 percent of large private-sector firms increased retiree contributions to premiums and 45 percent increased cost-sharing requirements. Further, 8 percent of surveyed employers eliminated subsidized health benefits for future retirees. Since 1988, the share of large employers offering retiree health benefits declined from 66 percent to 36 percent. Retiree health insurance coverage has become a key factor in negotiations between employers and employees, and in bankruptcy proceedings.

### ***Local Impacts, Health Sector Employers***

Health spending impacts at the local market level are typically viewed more favorably. As the health sector becomes a greater portion of GDP, employment and related activities in the health sector also grow. According to the Bureau of Labor Statistics, the health sector employed 6.3 million practitioners and technical workers as of November 2003.<sup>26</sup> Coupled with the 3.2 million Americans employed in health care support occupations, the health sector is a significant source of employment for American workers. For example, hospitals account for over \$1.3 trillion in economic activity annually.<sup>27</sup> By state, hospitals as a percent of total non-farm employment range from 4.1 percent in Nevada to 13.3 percent in North Dakota.

“Though health care costs are a significant burden to all levels of government, at the metropolitan level, that spending represents a substantial economic asset and potential leverage for improving job growth and wages.”<sup>29</sup>

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### **EFFECTS OF HEALTH CARE SPENDING— EMPLOYEES**

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Most economists combine wages and benefits when examining employee compensation and the dynamics of the labor market. Firms that continue to offer health insurance will focus on the total compensation, and when paying higher benefit costs may reduce wages (or wage growth) in an attempt to keep total worker compensation (wages and benefits) the same.<sup>30</sup> The empirical evidence has tended to show that health care cost increases are indeed offset by either direct wage reductions, increased employee cost sharing, or in instances where wages are fixed (i.e., unionized contracts), by increases in the number of hours worked.<sup>31</sup>

Finally, to the extent that firms are unable to offset cost increases via wage reductions or hour increases, work force reductions could result in layoffs, not replacing employees who quit, and/or increasing the number of part-time and temporary workers. Recent statistics support this understanding of the impact of health care spending on staffing decisions. While the overall labor force grew by 1 percent from July 2003 to July 2004, the number of individuals employed in temporary positions grew by 9 percent during the same time period.<sup>32</sup> Evidently, employers are choosing to differentially fill positions with temporary workers who do not have the attendant rising health care costs of full-time, benefit-eligible employees.

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#### **EFFECTS OF HEALTH CARE SPENDING—HOUSEHOLDS**

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In 2002 – the most recent year for which data are available – the average household spent \$2,350 a year, or 4.8 percent of its income, on health care. This is an increase from 1999, when the average household health expenditure was \$1,959, or 4.5 percent of income.

Households may also benefit from increased health spending through improved health status, increased access to care, wage and employment growth in the health care sector, and improved local economic activity. Improvements in health status may have a positive economic impact on households through increased productivity, reduced absenteeism, and enhanced independence.

As health care coverage costs increase, fewer individuals and families may afford private coverage and some of those with coverage may find it challenging to cover their out-of-pocket costs. In 2003, roughly 20 million American families, or 43 million people, reported financial problems paying medical bills.<sup>33</sup>

Rising health costs affect household finances. Income and savings that would otherwise be used for purchasing consumer goods, or put toward savings for financing future educational costs or retirement, must be used to cover health care services. For less affluent households, this could result in forcing tradeoffs between health care and other normal necessities of living. For example, a 2003 survey found that 63 percent of families that reported problems with paying medical bills also had problems paying for other household necessities, such as food, clothing, and rent.<sup>34</sup>

Low-income households without access to government or private sector charity programs may be particularly impacted by rising health care costs. A recent study reported that between 2001 and 2003 the proportion of insured low-income individuals with chronic conditions that spent more than five percent of their income on health care rose from 28 percent to 42 percent. Almost half of the uninsured low-income chronically ill have reported problems in paying medical bills, which has likely contributed to delaying or foregoing medical care.<sup>35</sup> In line with these cost-related health care choices, increased spending on health care led almost 6 million Americans to seek complimentary and alternative medicine (CAM) treatments in 2002 as a more affordable option compared to traditional medical care.<sup>36</sup>

Finally, increasing public sector health care spending will indirectly impact households. As indicated above, public sector financing requirements might result in increases in taxes, borrowing, or some combination of the two. Such increases would impact households via direct reductions in disposable income or increases in the cost of borrowing.

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- <sup>2</sup> R M Monaco and J H Phelps Health care prices, the federal budget, and economic growth *Health Affairs*, Summer 1995; 14(2): 248-259.
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- <sup>5</sup> D M Cutler and M McClellan, Is technological change in medicine worth it? *Health Affairs*, September/October 2001; 20(5): 11-29.
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- <sup>7</sup> Mark V. Pauly, Should We Be Worried About High Real Medical Spending Growth In The United States? *Health Affairs Web Exclusive*, January 8, 2003
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- <sup>14</sup> Pauly, M., "Should We Be Worried About High Real Medical Spending Growth in the United States," *Health Affairs*, January, 2003.
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- <sup>19</sup> EmploymentTrends. August 3, 2004. "Employer Health Insurance Costs Continue to Rise." Employment Policy Foundation.
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- <sup>28</sup> The Economic Impact of Hospitals in Washington State in the Year 2001, William B. Beyers, Department of Geography, University of Washington
- <sup>29</sup> The Other Side of the Ledger: Federal Health Spending in Metropolitan Economies, by Daniel Gitterman, Joanne Spetz, and Matthew Fellowes, September 2004, The Brookings Institution.
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<sup>33</sup> Tough Trade-offs: Medical Bills, Family Finances and Access to Care, Center for Studying Health System Change, Issue Brief No. 85, June 2004

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