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[Home](#) > [By Publication Type](#) > [Backgrounders](#) > [Healthcare Costs And U.S. Competitiveness](#)

Backgrounder

Healthcare Costs and U.S. Competitiveness

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1. [Introduction](#)
2. [Competitive Disadvantage](#)
3. [Health Reform's Impact on Business and the Economy](#)
4. [The 'Triple Tax'](#)
5. [Improving Value](#)
6. [Tapping Technology](#)

Introduction

The United States spends an estimated \$2 trillion annually on healthcare expenses, more than any other industrialized country. According to data from the Organization for Economic Cooperation and Development (OECD), the United States spends [two-and-a-half times more than the OECD average](#), and yet ranks with Turkey and Mexico as the only OECD countries [without universal health coverage](#). Some analysts say an increasing number of U.S. businesses are less competitive globally because of ballooning healthcare costs. U.S. economic woes have heightened the burden of healthcare costs both on individuals and businesses. The U.S. healthcare reform law signed by President Barack Obama on March 23, 2010, includes measures aimed at making healthcare less expensive and more accessible, including upgrades to government-run Medicare and Medicaid. Still, reforming healthcare has proved politically divisive, especially over the option to expand social medicine, as well as new mandates on employers and individuals. Whether these reforms will reduce the healthcare-cost burden on U.S. industry remains under debate.

Competitive Disadvantage

The United States spent more than [17 percent of its GDP in 2009](#) on healthcare, higher than any other developed nation. The nonpartisan Congressional Budget Office (CBO) estimates that number will rise to 25 percent by 2025 [without changes to federal law \(PDF\)](#). Employer-funded coverage is the structural mainstay of the U.S. health insurance system. According to the U.S. Bureau of Labor Statistics, about 71 percent of private employees in the United States had access to [employer-sponsored health plans](#) in 2006. A November 2008 Kaiser Foundation report says access to employer-sponsored health insurance has been [on the decline \(PDF\)](#) among low-income workers, and health premiums for workers have risen [114 percent in the last decade \(PDF\)](#). A March 2010 report by Thomson Reuters, a business intelligence service, found that [employers' healthcare costs rose 7.3 percent in 2009 \(PDF\)](#) compared with 4.8 percent in overall U.S. health spending that year. Small businesses are less likely than large employers to be able to provide health insurance as a benefit. At 12 percent, healthcare is the [most expensive benefit](#) paid by U.S. employers, according to the U.S. Chamber of Commerce.

Some economists say these ballooning dollar figures place a heavy burden on companies doing business in the United

States and can put them at a substantial competitive disadvantage in the international marketplace. For large multinational corporations, footing healthcare costs presents an enormous expense. General Motors, for instance, covers more than 1.1 million employees and former employees, and the company says it spends roughly \$5 billion on healthcare expenses annually. GM says healthcare costs add between \$1,500 and \$2,000 to the sticker price of every automobile it makes. Health benefits for unionized auto workers became a central issue derailing the 2008 congressional push to provide a financial bailout to GM and its ailing Detroit rival, Chrysler.

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Still, other experts debate the degree to which healthcare affects U.S. industries. "Health benefits are largely substitutes for other forms of labor compensation," says American Enterprise Institute Fellow Thomas Miller in a CFR.org roundup. "Hence U.S. firms have performed well [in the past], despite rising levels of healthcare costs, because high levels of productivity and a favorable investment climate were (and remain) much more important factors in determining competitiveness."

Healthcare is one of several factors--entrenched union contracts are another--that make doing business in the United States expensive, and it's difficult to parse the effects of each factor. Moreover, economists disagree on the number of U.S. jobs that have been lost to offshoring--the transfer of business operations across national boundaries to friendlier operating environments. A RAND June 2009 study published in the *Health Services Research Journal* found that industries with the highest level of employer-sponsored healthcare (such as manufacturing, telecommunications, education, and finance) showed the slowest amounts of growth between 1987 and 2005 compared to industries with the smallest level of employer-provided insurance in the United States and compared to their industry competitors in Canada, where insurance is provided by the state. *U.S. News and World Report* Money blogger Rick Newman uses some of the RAND data to project the decrease in industry growth and potential job losses for fifteen sectors should healthcare costs rise to 20 percent of U.S. GDP.

Some analysts say the healthcare situation affects the ability of startup companies to find the best workers, impeding U.S. innovation. "In the cradle of American innovation, workers are making career choices based on co-payments, preexisting conditions, and other minutiae of health insurance," writes David Leonhardt in the *New York Times*. "They are not necessarily making decisions based on what would be best for their careers and, in turn, for the American economy."

Health Reform's Impact on Business and the Economy

The healthcare reform legislation passed by Congress largely focuses on decreasing the number of uninsured--projections estimate reducing these numbers by about 60 percent, but it is less clear how much these reforms would affect the U.S. economy. Overall, the new law would produce close to \$1 trillion in new government spending. Although the CBO found that the final law would reduce the federal deficit (PDF) by as much \$138 billion by 2019, the Centers for Medicare and Medicaid Services, a U.S. government agency, also found that the legislation would do little to stem the rise in healthcare expenditures--expected to increase to more than 20 percent of GDP in the next decade.

The Senate Finance Committee's Democratic majority says its reforms will add an additional thirty million people with less than a 1 percent rise in overall expenditures (PDF). Democratic lawmakers say the law is paid for by new taxes and lower Medicare payments, but critics cast doubt on whether those lower payments--roughly half of the spending offsets (WSJ)--would ever come about. According to former CBO head Douglas Holtz-Eakin, if "unrealistic accounting" for Medicare, along with a number of other "gimmicks and budgetary games," is removed, the new law would actually cost \$562 billion in new government spending by 2019 (NYT).

The law mandates that employers either provide insurance for their employees or pay a penalty that would go toward government subsidies so employees could buy their own insurance. In a December report (PDF), the Lewin Group, a private consulting firm, found that employers currently providing insurance will see a reduction of \$223 per employee

in healthcare spending under the Senate's version of the bill, which became the basis for the new reform law--"primarily because the employer penalty is low enough that employers can afford to discontinue their plans." Non-insuring companies will pay \$316 per worker in new health spending, according to the Lewin report.

The 'Triple Tax'

Many company officials say a wasteful public-private system is pushing costs much higher than they should be. Jeffrey Rideout, a medical doctor and former head of the Internet Business Solutions Group at Cisco Systems' Healthcare Practice, says the amount businesses pay for employee insurance is just one element of their total healthcare costs. Rideout says businesses incur a "triple tax." First, they pay for insurance programs through health benefits. Second, businesses indirectly subsidize Medicare and Medicaid, the federally supported programs for primarily poor and elderly Americans.

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Businesses pay higher insurance premiums to make up for the fact that Medicare and Medicaid reimbursements often do not match the total costs hospitals incur treating these patients, a "hidden tax" confronted in a healthcare [proposal \(PDF\)](#) laid out by California Governor Arnold Schwarzenegger. Third, Rideout says, businesses also subsidize the strain on the system wrought by the cost of treating America's uninsured, again through higher insurance premiums.

It is unclear to what extent these concerns would be alleviated under the reform plan.

The new reform law expands access to Medicaid and the children's health program SCHIP. It also creates a new health exchange program that would allow small businesses and workers without employer-provided health insurance to purchase subsidized private insurance. In total, the plan is expected to cover more than thirty million people, but roughly another twenty million are expected to remain uninsured (one-third of whom are expected to be undocumented workers). One of the numerous ways the lawmakers hope to control costs is through reforms to Medicare, particularly by lowering payments to private insurers participating in [Medicare Advantage](#) and some health service providers. Whether such measures will simply [transfer higher costs to private plans \(Crain's\)](#), as some critics suggest, remains up for debate. A 2010 annual survey released in March by the National Business Group on Health, a coalition of big employers, found that more than two-thirds of large employers surveyed [expected their health costs to increase \(WashPost\)](#) as an impact of reform, and more than a quarter were considering reducing benefits to employees to control costs internally.

Improving Value

Healthcare experts agree the people with the most control over what drugs get prescribed and what procedures get done have little incentive to lower these costs (indeed, to the extent that they get paid by the procedure, their incentives are often quite the opposite). Likewise, patients often feel little need to control the costs of their own medical care if it is covered by insurance. The system bears the brunt of the excess, and employers make up the difference in the rates they pay.

While there is competition in the U.S. healthcare system, it operates at the wrong level, argue Harvard Business School Professor [Michael E. Porter](#) and [Elizabeth Olmstead Teisberg](#), a professor at the University of Virginia's Darden School of Business, the authors of the book *Redefining Health Care: Creating Value-Based Competition on Results*.

"Competition is both too broad and too narrow," Porter and Teisberg write. "Competition is too broad because much of the competition now takes place at the level of health plans, networks, hospital groups, physician groups, and clinics. It should occur in addressing particular medical conditions. Competition is too narrow because it now takes place at the level of discrete interventions or services. It should take place for addressing medical conditions over the full cycle of care, including monitoring and prevention, diagnosis, treatment, and the ongoing management of the condition."

The law tries to improve competition through the creation of a ["health insurance exchange" \(PDF\)](#) for small businesses

and individual buyers. But new competition in the marketplace may be limited. The CBO found that premiums for individual plans on these insurance exchanges would increase by 10 percent to 13 percent by 2016.

[Investment analyst Julia Coronado \(PDF\)](#) argues, "Most people covered by employer-sponsored plans will not see many changes or benefits from increased competition, so there is little expected impact from the [Senate bill] on healthcare inflation, although lower Medicare reimbursements will apply some downward pressure."

Some experts say companies should do more than focus their attentions strictly on direct costs of providing healthcare and look at the benefits of reducing poor health. Some health analysts argue there are "spin-off" benefits to supporting healthy employees such as productivity, intellectual capacity, and reduced absenteeism. Meanwhile, reviews have been mixed on whether the costly U.S. health system leads to health outcomes as good as developed countries with lower health costs. The law contains some measures that would monitor the quality of health outcomes of the insured.

Tapping Technology

Technology, too, can play an important role in minimizing overall health costs by improving efficiency and reducing mistakes. Rideout points out that the U.S. healthcare industry lags in information technology (IT) spending behind not only its [competitors internationally](#), but also other industries domestically. Rideout says the average company outside the health industry spends seven times as much as U.S. healthcare companies on information technology, and companies in some wealthier industries like banking spend up to twenty times as much. U.S. competitors abroad have also consistently outspent the U.S. government on healthcare IT investment.

One of the most commonly cited goals that could be spurred by increased investment is the shift to electronic medical records. Though critics worry about privacy, digitizing patient records achieves a number of ends at once: It cuts paper costs and also reduces the likelihood of errors in prescriptions and in the transfer of data between hospitals--flaws that can cause medical errors and prompt the need for expensive ongoing care. The new law aims to improve coordination among health providers electronically, including requiring all medical paperwork and billing transactions to follow uniform standards.

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