Will Health Care Reform Hurt the Economy and Increase Unemployment?

Timely Analysis of Immediate Health Policy Issues

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Despite rhetoric from both supporters and opponents of health reform, PPACA is unlikely to have a significant effect on the economy or on unemployment.

The Patient Protection and Affordable Care Act (PPACA) provides for a major expansion of health insurance coverage through Medicaid expansions and tax credits. The cost of the expansion is offset by cuts in Medicare payment rates and new taxes and penalties. Despite fears expressed by some in the political arena, health reform is not likely to have a significant direct effect on the U.S. economy or on employment. The changes in spending and taxes in health reform generally have offsetting effects and are simply too small relative to the overall size of the economy, to have much of an impact.

Over the six-year period, 2014–2019, the Congressional Budget Office (CBO) estimated net new federal spending on health care (over and above reductions in spending by Medicare and other government programs) to be about $439 billion.[1] The projected gross domestic product (GDP) over this period is about $116 trillion; thus, new spending would amount to almost 0.4 percent of GDP. Over the entire 2010–2019 period, new spending on health care (net of reductions in current payments) would be roughly the same while the GDP would be $178 trillion; over this period, spending would be 0.2 percent of GDP. Using a different modeling approach and considering spending from all sources, the Centers for Medicare and Medicaid Services (CMS) actuaries estimated the increase in national health expenditures to be $311 billion over 10 years, less than 0.2 percent of 10 years of GDP.[2]

Offsetting Effects

This does not mean that there will not be important effects on individual sectors of the economy. The expansion of health insurance coverage will lead to an increase in spending ($938 billion over 10 years, mostly from 2014 to 2019) and demand for labor in the health sector. It should also increase the use of medical equipment, new technologies and pharmaceuticals, and will likely lead to wage and salary increases in the health sector. Health reform is partially financed through spending reductions in Medicare and other government programs ($511 billion).[3] These reductions will have the opposite effect, that is, reduce the demand for labor and the purchase of services and equipment in health care sector. The net effect, however, will be positive, higher net spending in the health care sector.

On the other hand, the net new spending will be financed through various taxes on insurers, medical device and pharmaceutical manufacturers, and earned and unearned income of individuals with incomes above $200,000 ($250,000 for couples). The increased taxes on health care providers and insurers could mean higher prices for drugs, medical devices and insurance premiums, which could mean reduced demand for drugs and medical devices and, thus, fewer jobs in those sectors. These effects are likely to be small, as discussed below.

PPACA also includes an excise tax on high-cost insurance plans; the new tax is expected to increase federal revenues by $32 billion in 2018 and 2019 and increasing amounts thereafter.[4] The higher excise tax is likely to lead people to choose less comprehensive health insurance plans that presumably will have higher cost-sharing requirements than the plans people would purchase in the absence of the new tax. Thus, the government will either obtain revenue directly from the excise tax or from income taxes on the higher wages and salaries that will result as employers pay less for health insurance. The penalties paid by individuals who do not sign up for coverage and employers that do not offer coverage will yield another $69 billion in revenues.[5] The increased taxes, penalties, and higher out-of-pocket expenses (from less comprehensive coverage) will reduce

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the discretionary income individuals and families have to spend on other goods and services, which could consequently reduce the demand for labor in various sectors.

The increased payroll taxes on those with incomes above $200,000 will have a small effect on demand for goods and services because only a very small population will be affected, and the wealthiest people are the least likely to change their buying behavior as a consequence of a new tax. The same is true for the tax on unearned income and its effect on investment decisions. The estimated revenue from the taxes on payroll and unearned income is only $210 billion; again, this is over an eight-year period in which cumulative GDP is $148 trillion (0.19 percent of GDP).

The ultimate result is that the economic impact of coverage expansions, reductions in current Medicare and other government spending, and new taxes are largely offsetting. There is actually more in offsets and new revenues than in new spending, and thus a small reduction in the deficit ($143 billion). The overall effect on gross domestic product will be extremely small. Given that the health sector is one of the more labor-intensive sectors in the U.S. economy, health care reform could result in a small aggregate increase in employment. There are many other forces that will have a much greater impact on economic activity over the 10-year period than health reform.

Cost Containment

The efforts to contain costs will have the opposite effect. To the extent that the cost containment efforts are successful, they will reduce the growth in health care costs. This will reduce incomes in the health care sector, as well as the demand for labor, but will increase the discretionary income that individuals and families have. Thus, if the efforts are successful, there will be additional spending outside the health sector that will increase the demand for labor in other sectors.

Successful cost containment will have other economic effects as well. One will be to reduce the growth in spending on Medicare and, after the initial expansion, Medicaid. This reduces the taxes or borrowing the federal government has to undertake to finance these programs. The Council of Economic Advisers has argued that containing costs of the two large federal programs would reduce the federal budget deficit, increase national savings, keep interest rates lower, and increase economic growth.[6] The CBO and the Joint Tax Committee both project the excise tax on high-cost insurance plans to reduce the growth rate of annual health care costs by 0.5 percentage points per year once implemented.[7] Curtailing the growth of health care costs would mean lower costs for businesses and individuals. The Council of Economic Advisers has estimated that reducing the growth in health care costs by 1 percentage point per year would result in a GDP 4 percent higher by 2030.[8] This would occur because of a higher national savings rate, more capital formation, and higher output. Faster growth in GDP would mean more jobs, lower unemployment, and higher family incomes.

State and Local Governments

State and local governments will also benefit from reduced spending on state-funded indigent care programs and uncompensated care resulting under reform because of increased coverage. Medicaid enrollment will increase, but states will bear only a small share of the new Medicaid spending.[9] State and local taxes could thus be lowered, or states could redirect resources to education and infrastructure projects.

New Taxes and Innovation

Concerns have been raised that the taxes on drugs and medical device manufacturers could adversely affect innovation and discovery of new pharmaceuticals and technologies. This seems unlikely to be a serious concern because the new revenues in these industries from expanded coverage would considerably exceed the new taxes. The "fees" on drug manufacturers would amount to $27 billion between 2012 and 2019. When compared with projected prescription drug spending of almost $3 trillion between 2012 and 2019, the amount of the assessment is less than 1 percent of prescription drug spending over this period. These fees could be passed onto insurers, in which case drug manufacturers would suffer no loss in net revenues; this of course depends on drug companies' ability to negotiate with insurers. There is certain to be more demand for prescription drugs because of the expanded coverage. We estimate an increase in prescription drug revenues from expanded coverage of about $65 billion between 2014 and 2019, a considerably greater amount than the new fees.[10] Not all of this would mean higher profits for pharmaceutical manufacturers (a share of new revenues goes to wholesalers and retail outlets) but the new revenues should easily exceed the new taxes, if in fact the manufacturers do bear them in the end.

The same argument can be made for medical device manufacturers, though

the excise tax imposed on this industry will be somewhat greater as a percentage of spending on medical devices. Nonetheless, increased spending by newly insured people under reform will largely offset the negative effects of taxes. Thus, incentives for medical device manufacturers to innovate and create new products should be relatively unaffected by the new excise taxes. If the number of uninsured would have grown in the absence of reform, demand for medical devices would have declined. To the extent that expanded coverage means increased demand, the incentives for innovation in this area are at best increased and at least unchanged.

Impact on Small Business

Some have argued that penalties in the law for not offering coverage to workers who end up receiving government subsidies will hurt small businesses. This argument ignores the fact that small businesses (with fewer than 50 workers) will be exempt from any such penalties. The Council of Economic Advisers has estimated that insurance premiums for small businesses will fall considerably because of access to coverage through exchanges.[11] This will increase the competitiveness of small firms in the marketplace, increase entrepreneurship, and provide workers with greater incentives to work in small businesses.

The vast majority of businesses that are not exempt from the penalties under PPACA already provide coverage to their employees. In 2008, 97 percent of employers with 50 or more employees offered health insurance to their workers.[12] While a few businesses with more than 50 workers may have to provide coverage for the first time or pay a penalty if their workers obtain exchange-based subsidies, in the long run, much of the cost of coverage will be passed onto workers in the form of lower wages; the economic effects of this should be unimportant in practice, given the small number of employers affected. Some firms will not be able to pass the cost of coverage back to workers because of minimum wage laws. This could reduce profitability, or alternatively, could lead to reduced employment. Again, this is unlikely to affect the economy significantly because the increased spending on health insurance will mean a corresponding increase in the demand for labor in the health sector. In addition, some small firms will likely cease offering coverage, potentially leading to increases in wages and salaries. Overall, the impact on small businesses should be positive given the availability of lower-cost plans and the significant commitment to cost containment reflected in the law.

Other Effects

Health reform will affect the overall economy in other ways, but these effects are also likely to be quite small. First, health reform will reduce "job lock," that is, the tendency for individuals to stay in a given job to retain their health insurance. Because health reform will allow for considerably more flexibility in the movement from job to job, it will make the labor market more efficient and increase economic productivity. Second, to the extent that health reform improves health in the long term, as is expected, it should increase labor supply by reducing disability and worker absenteeism, improve learning, and increase workers' productivity. These effects, however, should take a considerable period of time and will probably have a relatively small impact on the economy.

Conclusion

PPACA is unlikely to have a major aggregate effect on the U.S. economy primarily because the changes in spending and taxes are quite small relative to the size of the economy; moreover, most of the effects offset each other. Increased spending will increase the demand for health services and the demand for labor in health sector. Cuts in Medicare and cost-containment provisions will have opposite effects. The net effect on employment is likely to be slightly positive because the health sector is labor-intensive. New taxes on insurers and medical device and pharmaceutical manufacturers could have adverse effects on those industries except for the fact that coverage expansion should provide new revenues well in excess of the new tax obligations. Cost-containment efforts, if successful, should reduce the growth in spending on Medicare and eventually on Medicaid, which would reduce the taxes or borrowing the federal government has to undertake. Cost containment that reduces the federal budget deficit would result in faster economic growth, more employment, and higher family incomes. The impacts on small businesses are likely to be insignificant, because most small businesses will be exempt from any penalties. Most firms affected by potential penalties (those employing 50 or more workers) already provide health insurance. Overall, small businesses should benefit from the availability of lower-cost plans and efforts to increase competition and contain costs within exchanges.

Notes

[1] Congressional Budget Office, "Letter to the Honorable Nancy Pelosi Providing Estimates of the Spending and Revenue Effects of the Reconciliation Proposal" (Washington, DC: Congressional Budget Office, March 20, 2010).

[2] Centers for Medicare and Medicaid Services, Office of the Actuary, "Estimated Financial Effects of the 'Patient Protection and Affordable Care Act'" (Baltimore, MD: Centers for Medicare and Medicaid Services, 2010).

[3] Congressional Budget Office, "Letter to the Honorable Nancy Pelosi," 2010.

[4] Congressional Budget Office, "Letter to the Honorable Nancy Pelosi," 2010.

[5] Congressional Budget Office, "Letter to the Honorable Nancy Pelosi," 2010.

[6] Council of Economic Advisers, the Executive Office of the President, "The Economic Case for Health Care Reform" (Washington, DC: Council of Economic Advisers, 2009).

[7] Council of Economic Advisers, the Executive Office of the President, "The Economic Case for Health Care Reform: Update" (Washington, DC: Council of Economic Advisers, 2009.

[8] Council of Economic Advisers, "Update," 2009.

[9] J. Holahan and I. Headen, "Medicaid Coverage and Spending in Health Reform: National and State-by-State Results for Adults at or below 133% FPL" (Kaiser Commission on Medicaid and the Uninsured, 2010).

[10] We derived an estimate of the growth in prescription drug spending due to increases in coverage as follows: Assuming drug spending remains constant as a share of expenditures by insured persons, we estimate about $300 in additional prescription drug spending by each of those who would gain insurance coverage under reform in 2014. Assuming the same growth rate for personal health care spending as currently projected in the National Health Accounts, and using CBO estimates of the reduction in the number of uninsured, we would predict that the prescription drug spending would increase by about $65 billion between 2014 and 2019.

[11] Council of Economic Advisers, Executive Office of the President, "The Economic Effects of Health Care Reform on Small Businesses and Their Employees" (Washington, DC: Council of Economic Advisers, 2009).

[12] Agency for Healthcare Research and Quality, Center for Financing, Access, and Cost Trends, "Percent of Private-Sector Establishments that Offer Health Insurance by Firm Size and Selected Characteristics: United States, 2008" (Rockville, MD: Agency for Healthcare Research and Quality, 2008), http://www.meps.ahrq.gov/mepsweb/data_stats/summ_tables/insr/national/series_1/2008/tia2.pdf.

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