Inoculate the Budget Deficit from Health Care Reform

William G. Gale

Abstract

In a contribution to *Real Clear Markets*, Bill Gale discusses health care reform.

Document date: May 08, 2012
Released online: May 08, 2012

Inoculate the Budget Deficit from Health Care Reform

The United States faces large federal budget deficits over the short-, medium-, and long-term. Although perhaps subject to the greatest public attention, the short-term deficits are generally thought to be helping the economy recover. In contrast, medium- and long-term deficits projected for years after the economy returns to full-employment are a source of concern: these deficits will create growing and serious burdens on the economy even if they do not lead to an immediate crisis. Â Economists of all political stripes agree on this point.

While extending the Bush tax cuts, if that occurs, will play a big role in making the medium and long-term deficit problems worse, economists agree that a key driver of the long-term deficit problem is growth in government spending on health care. Medicare and Medicaid, our two largest health spending programs, currently account for 23 percent of federal spending, or 5.6 percent of GDP. Under current law and optimistic assumptions for health spending, the Congressional Budget Office (CBO) estimates these programs will represent 30 percent of total federal spending (6.8 percent of GDP) by 2022 and will continue to grow thereafter.

The prospect of health-driven deficits has produced a burst of proposals for reform. Sadly, the simple truth is that we do not yet know how to reform government health programs to both rein in costs and maintain or improve quality and access.

One approach has been to maintain the current structure of the system but use better incentives (that is, restructure payments) to encourage patients and doctors to eliminate unhelpful or unnecessary medical procedures and instead focus on ones that are necessary and effective. The Obama administration's health care reform effort relies on this approach. However, the entity created to oversee this process, the Independent Payment Advisory Board, or IPAB, was effectively neutered by Republicans during negotiations leading up to the enactment of the Affordable Care Act.

Another approach, sometimes called premium support, would convert Medicare into what is, in essence, a voucher system. Medicare would offer subsidies to individuals to buy their own insurance from government-managed regional insurance exchanges. This approach, if adopted consistently, could limit government costs. It may not, however, limit overall health costs. Indeed, CBO recently estimated that under the "premium support" plan proposed by Rep. Paul Ryan (R-WI), total health spending for a typical beneficiary would grow faster under the proposal than under traditional Medicare.

So what do we do? The medium- and long-term deficits that will result from debt-financed health care spending will inexorably dampen economic performance. They will sap up capital, reduce our ability to grow, burden future generations with debt, and perhaps even influence the military and diplomatic stance of the country. We cannot, and indeed should not, wait for effective health care reform to rein in the budget deficit. Health reform is a process; it will take time to get it right as we learn about what works and what doesn't. We won't get it right on the first shot.

As we work to restrain health care cost growth, we must, at the same time, inoculate the future deficit from the inevitable failures of health reform.

We can do this by choosing a federal health care spending level and stipulating that any spending above that amount must be financed on a current basis with a tax. For example, if federal health care spending were allowed to grow at the rate of GDP plus 0.5 percent (a rate proposed by both President Obama and Rep. Ryan), any health spending in excess of that growth rate would be financed with tax revenues in the next year.

Suppose we used a value-added tax (VAT) to finance excessive health spending; using a VAT in this way would accomplish several goals and simultaneously mitigate general concerns about the VAT. Most importantly, the deficit could be controlled; the grinding economic effects of persistent long-term deficits

could be avoided even before society resolves the economically difficult and politically treacherous questions raised by trends in health costs.

In addition, the proposal would link health care spending and the means to pay for such spending. When considering whether health spending should rise, voters would have an explicit choice between higher spending and higher taxes on the one hand or lower spending and lower taxes on the other.

Some will inevitably oppose this fiscally responsible proposal simply because it uses a VAT. At a recent Brooking conference, Larry Summers restated his classic summary of political opposition to a VAT: conservatives worry that it is a money machine and would fuel expansionary government, and progressives worry that it is regressive. He concluded that a VAT will only be possible when conservatives realize it is regressive and progressives realize it is a money machine.

Although Summers' characterization captures an important aspect of the VAT debate, linking the VAT to health care spending would help address both issues. A VAT linked to health care spending would necessarily be less of a money machine than a VAT that provides general revenues--it would limit voter willingness to raise health care spending, not provide a reason to increase it. Â It may also change their health care consumption and reduce demand for techniques and procedures that may not be effective or necessary. A VAT linked to health care spending would also be less regressive than a general-revenue VAT because it would finance a widely-distributed good.Â Any regressivity could be further lessened by demogrants or income tax credits.

Linking a VAT to health spending is not a new idea. It has been proposed by my colleagues Henry Aaron (20 years ago) and Isabel Sawhill, Syracuse economist Len Burman, and others. But it is certainly an idea whose time now has come, given the negative effects of persistent deficits on economic growth and the difficult technical and political aspects of health care reform. Health care reform is a desperately important task and should proceed apace. But it will take time and it should not hold hostage the effort to reduce medium- and long-term budget deficits.

Other Publications by the Authors

- William G. Gale