IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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CBO CONFIRMS: NO UNIT COST HIKES INCLUDED IN ESTIMATES OF HEALTH PLANS

The Congressional Budget Office (CBO) has probably understated the cost of the health care reform measures before the Congress by omitting the rather obvious effect of the higher subsidies on people's demand for health care and on the unit costs of providing it. Anyone concerned with the cost of the insurance proposals should take note.

Last October, we wrote[1] of our concern that the CBO estimate of the cost of the Senate Health bill may have omitted this important factor. Providing some 30 million additional people with subsidized health insurance and Medicaid would increase their demand for health care services beyond what they currently consume. The added demand would raise costs, as the industry strained to increase its services. The unit cost increase would impact all current consumers of health care. That includes the federal government, which spends a trillion dollars a year on Medicare, Medicaid, federal retirees' health benefits, the VA medical system, and Indian health programs (over half of all health care spending in the country). Another $250 billion in tax benefits for the exclusion of employer-provided health insurance premiums would be affected.

We estimated that the price pressure from the higher demand for health care could add about $75 billion to the cost of these other government tax provisions and spending programs over the last six years of the budget window (and boost the government's expenses by more than $125 billion over ten years). This cost increase for other programs and provisions due to the health bill should be considered part of the cost of the bill. It was not clear at that time whether the CBO estimate allowed for such effects. It is clear now.

On November 30, CBO Director Douglas W. Elmendorf sent a letter to Senator Evan Bayh detailing CBO's methods and results for estimating the cost of the Senate bill.[2] On page 4 of the letter, he states:

> "The analysis does not incorporate potential effects of the proposal on the level or growth rate of spending for health care that might stem from increased demand for services brought about by the insurance expansion or from the development and dissemination of less costly ways to deliver care that would be encouraged by the proposal. The impact of such 'spillover' effects on health care spending and health insurance premiums is difficult to quantify precisely, but the effect on premiums in 2016 would probably be small."

We are happy to have the assumptions behind the estimates presented so clearly. However, we are not happy with the assertion that the effect on health care spending and on premiums would likely be small by 2016. We have seen unit costs in the health care area rise dramatically, in part due to the expansion of insurance and health care demand over the past 50 years. We do not expect the rather

speculative cost containment and efficiency-enhancing provisions in the bill to offset such impacts. We suspect that costs will be driven higher by 2016, and rise further thereafter as more people learn to make use of the new insurance. The nation will need more doctors and nurses, more laboratory technicians, more hospitals and nursing homes, more medical supplies and devices, and more housekeeping and other support staff. Not everyone is cut out for a medical career, and finding additional human and physical resources to enlarge the already-huge health care industry will be costly.

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Endnotes

1. Stephen J. Entin, "CBO Underestimates Cost Of The Senate Finance Health Bill," *IRET Congressional Advisory*, No. 259, October 12, 2009, accessed at http://iret.org/pub/ADVS-259.PDF.

2. Congressional Budget Office, "An Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act; Letter to the Honorable Evan Bayh, November 30, 2009, accessed at http://www.cbo.gov/ftpdocs/107xx/doc10781/11-30-Premiums.pdf.