Sample Term Paper 2

Increased Government Spending on Health Care:
Investing In Sources of Long-Term Growth

bv
BQL - 12pm
Sahan

"U.S. Needs a New Prescription to Slow Health-Care Spending"
The Wall Street Journal
March 6th 2006

Introduction

The article I chose describes the problems associated with the rising cost of health care in America and how to slow the growth of health care spending. It discusses the Organization for Economic Cooperation and Development (OECD), a group of economists located in Paris and paid for by thirty different countries, including the United States. The OECD is worried that government gross investment on health care in industrialized countries is going to increase. Government gross investments are the expenditures made by federal, state and local government for final goods and services. They suggest that without policy action it will double from 6.7% of the gross domestic product (GDP) to 12.8% by 2050. Policy action refers to action taken by the government to influence the state of the economy. Gross domestic product is the total market value of a country's output. The OECD suggests the reason for this increase is because there is a pattern of the government expenditures on health care to rise 1% faster than incomes, even after adjusting for aging populations. This occurs simply because when people have higher incomes and acquire more wealth they spend more on health care. Income is a flow measure of the sum of all of a household's wages, salaries, profits, interest payments, and other forms of earnings in a given period of time. Wealth is a stock measure of the total value of what a household owns minus what it owes. They also add that, even if the government could eliminate the 1% of spending growth, the public spending on health care will, on average, still reach 10% of the GDP. It is also noted that the United States spends a higher fraction of its GDP on health care per capita, per person, than any other country.

It is suggested in the article that health care along with other rising costs of social expenses make the government expenditures difficult to manage. A solution suggested is that the government controls its spending by setting budget priorities and deciding the right ways to

invest their spending. The spending of the government should be aimed at creating the most beneficial medical outcomes. The article suggests that aiding in education, which would increase human capital, would result in higher worker productivity, and therefore more advances in health care. Human capital is the amount of training provided to a human. Worker productivity is the output from workers determined by the amount of human and physical capital.

Health care costs will also rise as the age of the population rises. This rise occurs simply because when more people get older the cost of health care will increase. In extreme cases, disabled or elderly people who require constant care push the cost up over extended periods of time. The alternative to paying for this constant care would be if the families would help their elderly or disabled family members. However, because more women are joining the work force and other workers are working longer now, they do not have time to provide this additional constant care to family members. This in turn increases the government expenditures on this constant health care. The government expenditures on this constant health care, alone, currently account for 1.1% of the GDP, but if the same patterns continue this number could possibly double in size. The OECD says that the government is ignoring these problems and dealing with only pension spending because it is easier to evaluate and come up with resolutions.

The article concludes by comparing the United States' way of financing health care compared to other countries like Canada and Britain. It states that these two countries finance their health care mainly through taxes. On the other hand, within the United States 55% of health care costs are paid by individuals and the businesses they work for. Despite this high percentage, the United States government still spends, on average, 7.2% of the GDP on all health care. The conclusion is that the United States and other industrialized countries are going to be challenged by the rise in the government spending devoted to healthcare for various reasons.

Theory Review and Analysis

The concerns of this article suggest that when income, cost of medical technologies and long-term health care increase government spending on health care will ultimately increase. If there is no policy action taken to decrease government spending on health care, there will be a negative affect on the Unites States economy. As shown in graphs 1, 2, 3, and 4, due to an increase in government expenditures, the output (income) of the economy will increase by a multiple of the initial increase in government spending because aggregate expenditures will increase. This initial short-run effect is not negative in effecting the economy because an increase in output (income) means stimulated growth (Graph 1). The reason it is negative is because of the secondary effects shown in Graph 4. The increase in output will cause an increase in the demand for money within the money market (Graph 2), assuming the Federal Open Market Committee keeps the money supply constant. This increase in money demand will cause an increase in interest rates and by observing the planned investment schedule (Graph 3) this increase in interest rates will cause a decrease in investment. When this investment decreases, so will planned aggregate expenditures and output (income). This has a crowding out effect on the economy and causes a reduction in private investment spending (Graph 4). There is also an increase in the federal government's deficit that occurs with an increase in government spending.

The article also suggests that other countries such as Canada and Britain do not have this problem because they fund their health care through the taxes that they collect. This would imply that if the United States increased their taxes then they could afford to fund the increase in health care costs. As shown in graph 5, an increase in net taxes would decrease consumption expenditure and cause firms' inventories to be higher than planned. Firms would then decrease output and also income. The decrease in income causes a decrease in money demand in the

money market (Graph 6). A decrease in the money demand also decreases the interest rates. Since interest rates are lower people are more likely to invest (Graph 7). This increase in investment increases planned aggregate expenditures and also output (income).

Another problem presented in the article is that the government is spending far too high of a percentage of the GDP on health care. It mentions that it is projected to equal 16.2% this year at the rate that they are spending. There is further suggestion that just because they need to spend money on health care and are spending the money does not mean they are spending it on the right things. As displayed in Graph 1 there will be a short-run increase in output (income) with an increase in government spending on health care. It is also possible to spend this money on other sources of economic growth that will better the economy in the long-run.

Four elements can trigger economic growth within our economy. One is an increase in physical capital, which enhances the productivity of labor and provides valuable services. In this situation, the government could build more hospitals and provide more medical equipment to decrease healthcare costs later on. Another is an increase in human capital, which helps because people with skills and education are more productive. In this case the government could fund educational scholarships for individuals within the healthcare field. This would increase the amount of health care providers and decrease costs of health care. Increases in productivity also increase growth. This can be done through changes in technology, advances of knowledge, and external economies of scale. External economies of scale save costs through an increase of the size of industries. All of these sources of growth affect the economy in a different way than just increasing output as shown in Graphs 9 and 10. Graph 9 shows how an increase in government spending only causes movement along the Production Possibilities Frontier (PPF). Graph 10 shows a shift in the PPF curve caused by an increase in sources of growth.

Conclusion

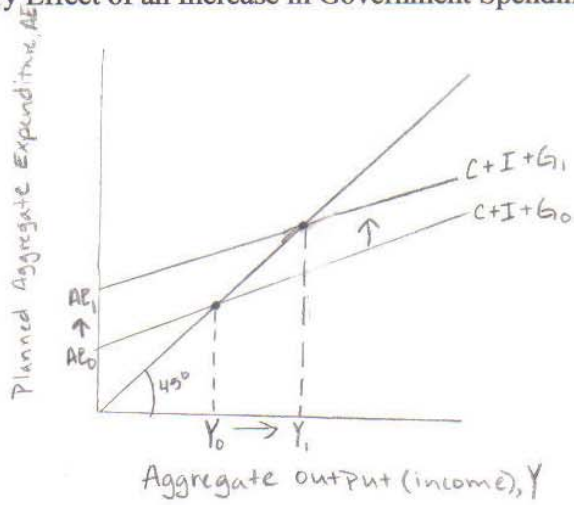
I believe that the article's suggestion about increasing net taxes to fund health care is not necessarily a bad idea, but a very controversial one that would be difficult to implement. It would be difficult because fiscal policy, such as increasing net taxes, has a long implementation lag because Congress must authorize the change in fiscal policy. An implementation lag is the time it takes to put a policy into effect. America might not be able to wait because of the rate at which healthcare costs are increasing, especially with the Baby-boomers who will require a large amount of health care around the time when they retire. I believe that there is a better solution than increasing net taxes.

It is inevitable that some government spending will have to occur in order to fund the increased costs in health care. I believe that the main issue is what to spend it on. Directly spending the money on immediate, short-run fixes to the increase in costs seems to solve the problem. However, fixing things in the short-run also means that the problem will remain in the long-run and will have to continually be fixed. This will in turn create an increase in the government's deficit. In my opinion an increase in the deficit is a bad thing because this means that the government is spending more than it is collecting in taxes. If this deficit were to increase then so would taxes and this would have a negative long-term effect on the economy.

I believe that the government should invest in sources of growth that will have a positive effect on our economy in the long-run and eventually solve the problem of increasing the government's constant spending on health care. New advances in technologies and production methods, for example, lead to new and better products that maybe used to decrease the costs of health care in the long run. An increase in economic growth will also improve living standards and lift people out of poverty.

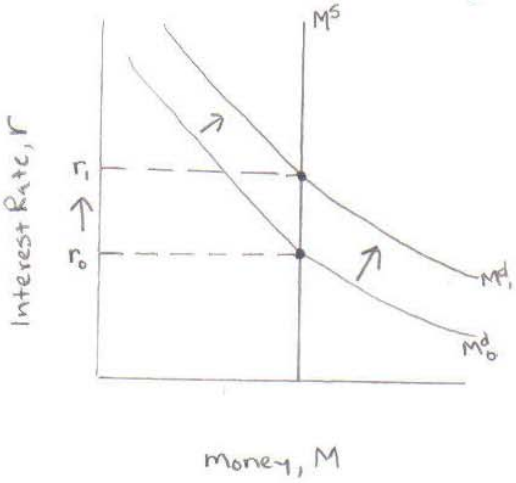
Graph 1

The Primary Effect of an Increase in Government Spending within the Goods Market



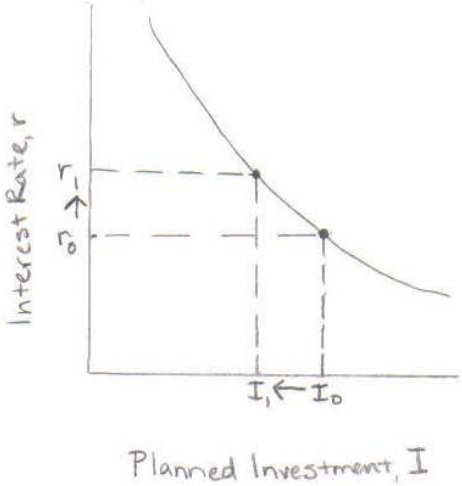
Graph 2

The Effect of an Increase in Government Spending in the Money Market



Graph 3

The Effect of an Increase in Government spending on the Planned Investment Schedule



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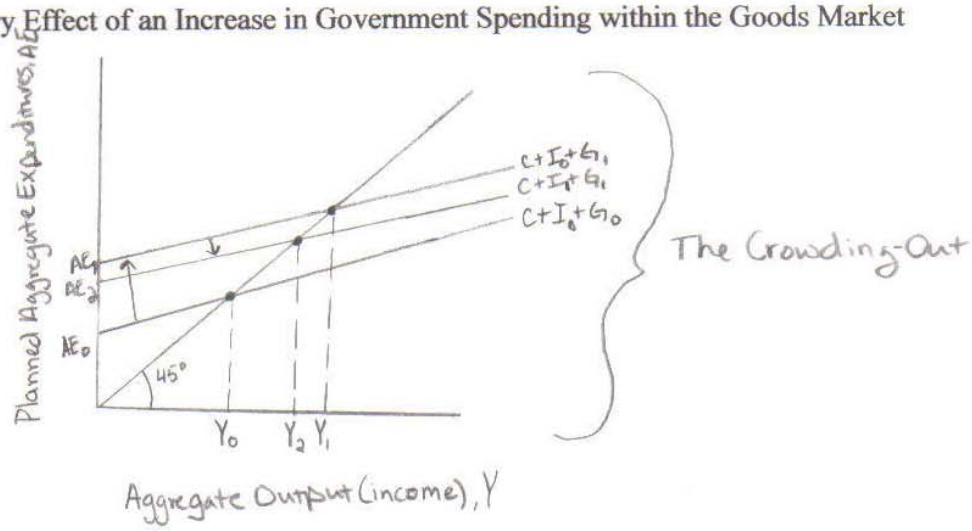
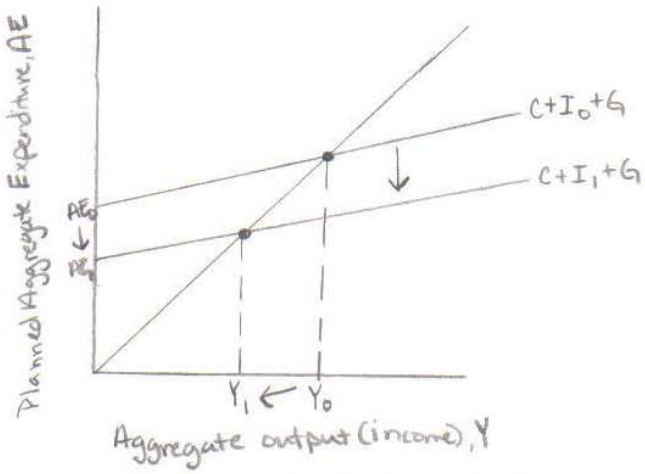
Graph 4

The Secondary Effect of an Increase in Government Spending within the Goods Market



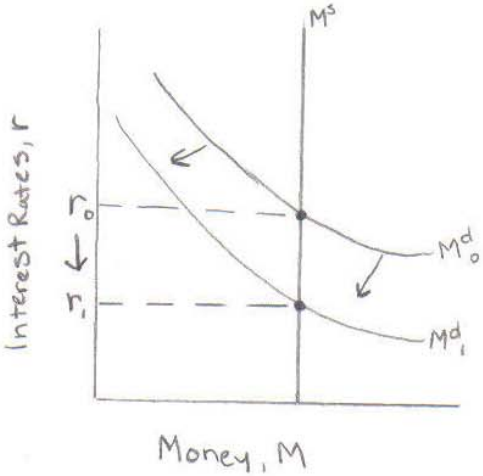
Graph 5

The Primary Effect of an Increase in Net Taxes within the Goods Market



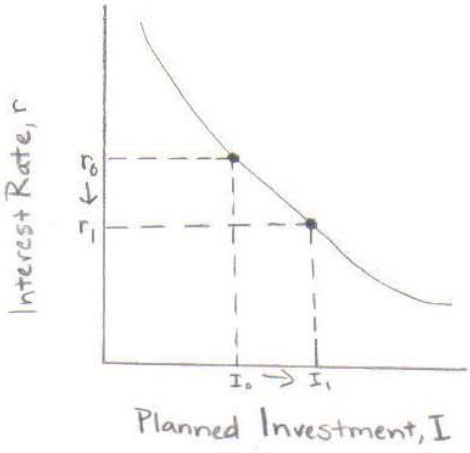
Graph 6

The Effect of an Increase in Net Taxes within the Money Market



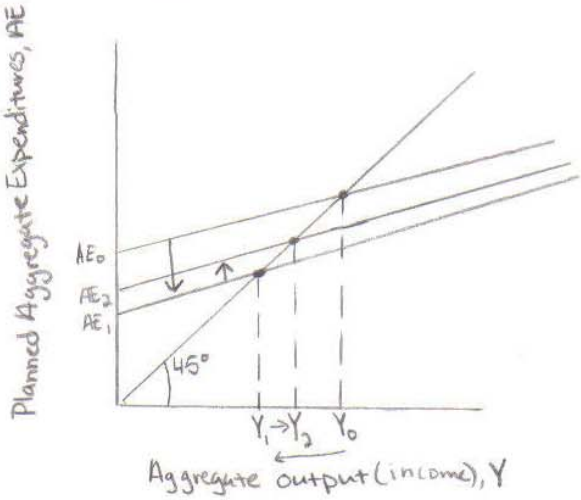
Graph 7

The Effect of an Increase in Net Taxes on the Planned Investment Schedule



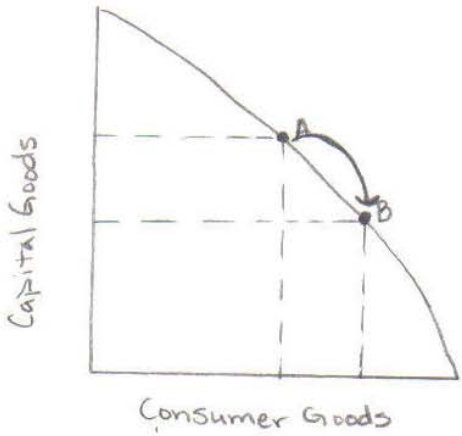
Graph 8

The Secondary Effect of and Increase in Net Taxes within the Goods Market



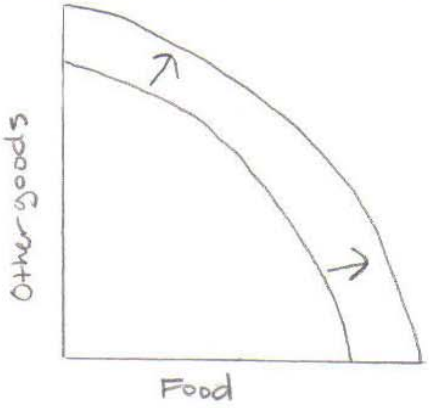
Graph 9

The Effect of an Increase in Government Spending on Society's Production Possibilities Frontier



Graph 10

The Effect of Economic Growth on Society's Production Possibilities Frontier



THE WALL STREET JOURNAL.

U.S. Needs a New Prescription to Slow Health-Care Spending

Rafael Gerena-Morales. **Wall Street Journal.** (Eastern edition). New York, N.Y.: Mar 6, 2006. pg. A.2

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Abstract (Document Summary)

The urgent implication, says Gerard Anderson, an economist at the Johns Hopkins Bloomberg School of Public Health, is that governments -- especially the U.S. -- need to focus the added spending in ways that lead to better medical outcomes. "We're going to spend more, but the question is whether health care is going to get better in the future," he says. The OECD report "tells all the countries that they'll have to do something" to try to control spending, he continues. "The next question is 'What do they do?' Each country has a different prescription."

Adds economist Karen Davis, president of the Commonwealth Fund, a philanthropy that studies health- and social-policy issues: If health spending "is well directed, it can get a good return" in terms of education and worker productivity. "Just spending more doesn't mean you're spending on the right things."

Aging populations also will push up health-care costs: Older people tend to use more health care. But the OECD says a less commonly recognized driver is the cost of long-term care for disabled or elderly people who cannot eat, bathe or dress themselves. Families are less likely to provide this care in the future, the OECD predicts, as more women in nations such as Italy, Ireland and Spain enter the work force and other workers remain on the job longer. That's likely to increase the government tab for long-term care. Today, government-paid long-term care accounts for 1.1% of GDP on average among the 30 OECD nations. By 2050, it is projected to triple if current trends persist, and more than double even under the OECD "cost containment" scenario.

Full Text (893 words)

THE RISING COST of health care is becoming an American obsession -- among business executives, politicians, workers and retirees. Would-be reformers occasionally glance across the Atlantic, or to Canada, and wonder if their systems, though plagued by long waiting lists and other well-publicized shortcomings, offer ways to slow the growth of health-care spending.

But economists at the Organization for Economic Cooperation and Development, a think tank in Paris bankrolled by 30 developed countries from Australia to the U.S., are waving a red flag.

In a recent report, these economists say government spending on health care in industrialized countries is on track to increase from an average of 6.7% of gross domestic product today to 12.8% by 2050 "in the absence of policy action to break with past trends." The trend, they say, is for government spending on health, even adjusted for aging populations, to rise 1% faster than incomes.

And even if governments somehow find a way to eliminate that extra one percentage point of spending growth, the OECD expects public spending on health care, including long-term care for the elderly, to reach 10% of GDP on average. The projected increases are sharp even in countries that have kept overall spending on health care far below the U.S., which spends more per person and a greater fraction of its GDP on health care than any other country.

"If you add these costs with other rising social expenses -- education, pensions and poverty [reducing] programs, it becomes quite difficult to manage. This makes it very important that governments control spending and set clear [budget] priorities," says Joaquim Oliveira Martins, one of the report's co-authors.

The urgent implication, says Gerard Anderson, an economist at the Johns Hopkins Bloomberg School of Public Health, is that governments -- especially the U.S. -- need to focus the added spending in ways that lead to better medical outcomes. "We're going to spend more, but the question is whether health care is going to get better in the future," he says. The OECD report "tells all the countries that they'll have to do something" to try to control spending, he continues. "The next question is 'What do they do?' Each country has a different prescription."

Adds economist Karen Davis, president of the Commonwealth Fund, a philanthropy that studies health- and social-policy issues: If health spending "is well directed, it can get a good return" in terms of education and worker productivity. "Just spending more doesn't mean you're spending on the right things."

AMONG THE BIGGEST drivers of health spending around the globe are the cost of medical technology and the effect of rising incomes. "When people become richer, they spend more on health care," says Mr. Oliveira Martins.

Aging populations also will push up health-care costs: Older people tend to use more health care. But the OECD says a less commonly recognized driver is the cost of long-term care for disabled or elderly people who cannot eat, bathe or dress themselves. Families are less likely to provide this care in the future, the OECD predicts, as more women in nations such as Italy, Ireland and Spain enter the work force and other workers remain on the job longer. That's likely to increase the government tab for long-term care. Today, government-paid long-term care accounts for 1.1% of GDP on average among the 30 OECD nations. By 2050, it is projected to triple if current trends persist, and more than double even under the OECD "cost containment" scenario.

The OECD did the projections, in part, to warn governments around the world that the economic burden of aging populations isn't limited to pensions, a subject of perennial political debate in several countries, including the U.S., where President Bush tried unsuccessfully to reshape Social Security. "Despite the orders of magnitudes involved, policy discussion in many countries has focused less on health and long-term care spending than on pension spending," the report says. It suggests that analyzing problems and identifying solutions with pensions is easier than with health care.

IN MOST OECD countries, including Canada and Britain, health-care systems are financed primarily through taxes. In the U.S., by contrast, about 55% of the health-care bill is paid by individuals and their employers. Yet U.S. government spending on health care -- mainly Medicare and Medicaid -- amounts to an above-average 7.2% of GDP. (Overall U.S. health-care spending, private and public, this year is projected to equal 16.2% of GDP.)

Averages, of course, mask striking differences among countries. Italy, Japan and Spain are aging more rapidly than other countries, and health-care spending will rise accordingly. Mexico, where government health-care spending currently amounts to 3.1% of GDP, is likely to see rapid increases because it begins from such a low base. Countries with relatively low fractions of adults in the work force, such as Italy, Ireland and Spain, may see a substantial increase in demand for formal long-term care if those adults go to work. And countries like Sweden, which has an older population than some other countries and whose government already spends 8.6% of GDP on health care, may not see as much of an increase.

Though their circumstances differ, industrialized countries face a common challenge: An inexorable rise in the share of government budgets devoted to health care, a widespread conviction that present trends are unsustainable and little political consensus on what to do about it.