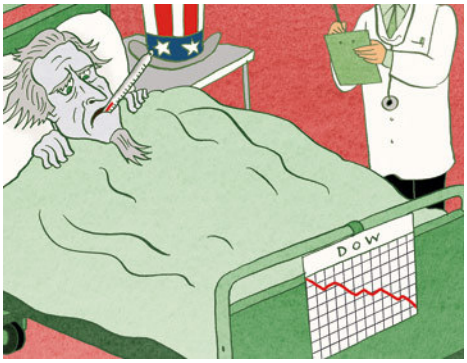
In need of desperate remedies

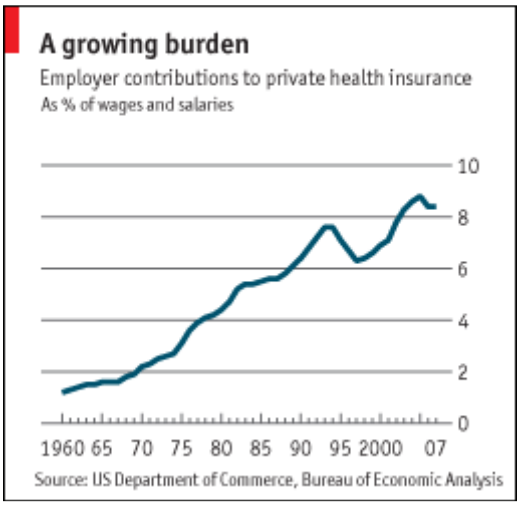


TOMMY THOMPSON, a former secretary of health who made his name spearheading health and welfare reforms when he ran Wisconsin, is convinced that "2009 will be the biggest year for the transformation of health care." On the face of it, it seems a strange assertion, given the global financial mess that is sure to dominate the next president's first year.

After all, that financial panic shows obvious signs of spreading into the real economy, as the parlous state of Detroit's car manufacturers makes clear (see article). But soaring health costs are one of the big factors that have brought those car firms to the brink in the first place. Detroit's automobile manufacturers claim they spend over $1,500 per car on health costs, far more than is paid by foreign firms from countries with taxpayer-funded health care. So a coming recession may end up as a powerful impetus for health reform.

Thanks to a pact made by big business and labour half a century ago, most Americans receive their health coverage through their employers. Government has encouraged this compact by not classing company-provided health cover as a taxable benefit; people who buy their own, by contrast, have to do so with post-tax dollars. Economists criticise this tax concession, which is reckoned to cost the federal exchequer over $200 billion, for a variety of reasons: it favours the rich, discriminates against the self-employed and hinders labour mobility.

But companies are starting to rebel. Tax break or no tax break, increases in health costs, which have long outpaced inflation, have meant that employers are spending ever greater amounts on providing cover. Those costs have nearly doubled this decade alone, and a new report by Towers Perrin, a benefits consultancy, forecasts they will surge by another 6% in 2009. This, firms argue, burdens them with unfair costs. "The price tag for this care makes many American goods and services relatively more expensive," complains the National Business Group on Health (NBGH), which represents many of the country's biggest employers.



It is quite a U-turn for big business to go from undermining Hillary Clinton's attempts at providing health cover for everyone in the 1990s to lobbying for a government role in health reform. Mark Smith, the head of the California HealthCare Foundation, a charity, worked in the Clinton administration on that ill-fated plan. Back then, he observes, business leaders were so suspicious of government that they fought the plan, even though it would have reduced the burden on industry. Ironically, firms ranging from Wal-Mart to Detroit's car manufacturers today think "only the government can save us."

Not everyone buys industry's arguments about rising health costs imposing a competitive disadvantage on firms. Conventional economic theory maintains that firms should be indifferent to whether they pay employees cash wages or benefits. The two are seen as fungible, and are both tax deductible. So if the cost of health benefits rises, employers ought to be able simply to cut wages—or pass on those costs as higher prices to customers.

This theory is correct over the long term but falls apart in the short term, argues Len Nichols of the New America Foundation, a Washington, DC-based think-tank. In competitive global markets, firms usually cannot pass on health costs as easily as price increases since rivals overseas do not pay nearly as much via taxes to support state health systems.

And many firms cannot simply slash wages to offset increases in health costs. Employees guard their salaries more fiercely than other benefits and unions still have clout. Towers Perrin calculates that employers are therefore being forced to absorb about four-fifths of the increase in health costs. Soaring health costs depress wages below where they would otherwise be, and make for a sicker, more disgruntled workforce and poor labour relations.

What, then, to do? The boldest idea for reform now gaining currency is to abolish the tax advantage enjoyed by employer-based health cover. For decades, this was taboo, but no longer. First, John McCain has made abolishing this tax distortion the centrepiece of his health plan—though his ideas on what happens after the current system is abolished are rather less coherent. The New America Foundation has also recently proposed a variation on this that would cap the current tax deduction so that the wealthiest can no longer enjoy tax breaks for sumptuous so-called Cadillac plans.

A more comprehensive proposal comes from Senator Ron Wyden, a Democrat from Oregon whose Healthy Americans Act (HAA) would scrap the tax benefit and replace it with a fixed tax deduction for employees so that they could, as with Mr McCain's plan, buy coverage from either private or public sources. But this plan goes further to address likely market failures. The HAA imposes an individual requirement to purchase insurance, offers subsidies for the poor and sets up state-run insurance pools that should keep premiums down. It also demands that employers giving up health coverage convert health benefits into wages.

Cherry picking, lemon dropping

Because the HAA harnesses the vast pool of money that is today distributed inefficiently through the tax break for employer-provided care, and then couples it with clever cost-control mechanisms, the Congressional Budget Office and the Joint Committee on Taxation have judged that the HAA will be revenue neutral or even revenue-enhancing within a few years. This is more than can be said for Barack Obama's plan, which would expand coverage, but at a hefty cost. It has helped the HAA win the support of a bipartisan group of 16 senators, including such Republican budget hawks as Judd Gregg. Even the American Medical Association, the lobbying group for doctors that has been extremely wary of reforms, threw its weight behind the HAA in September.

The attraction of a coherent, fiscally sound, bipartisan reform—be that the HAA or some variant on it—is great. But given the thorny politics and vested interests involved in a sector making up roughly a sixth of the American economy, the odds are still stacked against it.

An alternative might come from state-led experiments. For instance, Massachusetts is trying to achieve universal coverage first before tackling costs. Critics complain that the scheme's total costs have been higher than expected, but the flip side has been a dramatic expansion of coverage at a relatively low cost per head. The federal government has just given its vote of confidence to this state effort, agreeing on September 30th to a three-year deal that will provide $10.6 billion in federal money to support the state's experiment.

Another possible way forward is the incremental approach. Mr Thompson thinks there is enough consensus in Washington, DC, to take modest but useful steps towards making greater use of IT in health care ("e-prescribing", for instance) and to reform the way chronic diseases such as diabetes are treated.

David Snow, the boss of Medco, a giant "pharmacy benefits manager" or drugs middleman, put forward his own plan in September for five discrete reforms that he thinks can squeeze $1 trillion in costs out of the system over time: more information technology, fixing Medicare's financial health, reforming medical liability laws, reducing medical errors and promoting prevention. Hardly an original list, but the problems are well known.

In sum, there is something new under the sun. After decades of dawdling and delay, it seems America may finally be coming to grips with the health system's runaway costs. The coming economic difficulties may help, both by forcing politicians to rise above petty politics to pay attention to serious issues like health reform—and by limiting the menu of options they have for pursuing such reform.

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