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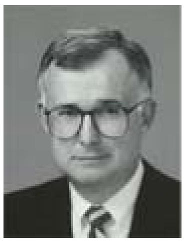
The Recession and its Effect on Healthcare



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This article has been heavily edited for publication. The complete article appears here.

AMERICA IS IN A SEVERE RECESSION. Last November, the U.S. lost over half a million jobs, the largest one month drop in employment in 34 years. That brought the total jobs lost in 2008 to 1.9 million. A job loss usually means a family will lose its health insurance.

Magnitude of the problem.

We are close to the line that separates a recession from a deflation. America's household balance sheets shed almost $3 trillion in the third quarter of 2008, thanks in large part to declining stock prices. That loss, the largest 3-month drop on record, brings the total loss by U.S. households in 2008 to $10 trillion, or about 10 years worth of equity earnings.

Beyond stocks and bonds, most family wealth is based on real estate. Household real estate assets fell for a 10th quarter out of the past 11 and the net worth of real estate is now down 32 percent since 2005. This is an unprecedented loss of family wealth - almost $6 trillion in real housing wealth in 2008, or on average of $85,000 per homeowner.[1]

In addition, retirement accounts have been devastated. Since October 2007, 401(k)s have lost $1 trillion in value - fully a third of the value of all 401(k)s. Another $1 trillion has been stripped from people who lost or changed jobs and rolled their 401(k)s into individual retirement accounts. Millions of others have been forced to make early, so-called hardship withdrawals for unanticipated expenses.

Spending by consumers, which has sustained the economy over the past decade, is in free fall. Most consumer spending has been based on mortgage debt. Mortgage-based debt declined in the third quarter of 2008 by 1.7 percent, the first decline in 25 years, resulting from an end of mortgage equity withdrawals.

The economic damage from prior consumer debt-based spending is becoming apparent. A recent report by New York University Professor Nouriel Roubini indicates credit debt could peak at $3.6 trillion for U.S. institutions.[2] If this prediction proves accurate, the U.S. banking system is effectively insolvent because it starts with a capital of $1.4 trillion. Thus, the new Obama Administration will have to use as much as $1 trillion in yet uncommitted public funds to shore up capitalization of the banking sector.

America's true wealth is based on productivity, not paper derivatives. Here again, the news is not good. After averaging 2.7 percent productivity growth from 1995 through 2002,[3] annual growth of productivity in the non-farming business sector has slowed dramatically - to just 1.7 percent in 2005, 1.0 percent in 2006 and 1.4 percent in 2007. At this last rate, it would take nearly 52 years for average living standards to double - versus just 26 years at the earlier rate.

This decline in productivity is reflected in the Labor Department's employment report for December. Employers shed more jobs in 2008 than in any year since 1945. Worse, the pace of job loss is accelerating. In the third quarter of 2008, the economy shed an average of 199,000 jobs a month; in the fourth quarter, 510,000 jobs were lost on average each month. Moody's Capital Markets Group in New York predicts about 2.1 million U.S. jobs will be lost in 2009 with 80 percent of the layoffs by the 4th of July.

What is the long-term significance of these figures? Are we facing a recession bordering on deflation or are we redefining the country's wealth? If a severe recession, the economy over the next few years will begin to recover and show increasing rates of growth.

It is an entirely different issue if we are redefining actual wealth - and that appears the most likely result. An early indicator is a recent announcement by Standard & Poor's. The rating firm reported the U.S. Treasury bond would lose its AAA rating by 2012 because Washington has been reporting the government's financial statements with a cash accounting rather than an accrual accounting methodology. America will then have the same credit rating as Estonia, Greece, Poland, Brazil, and Mexico. The borrowing spree funding the US spending will come to an end when foreign investors, particularly the Chinese Government[4], no longer buy America's bonds.

For the short term, the recession will affect every segment of the economy. For the long term, if we "right size" the country's wealth, we will need to right size all segments of the economy - with serious implications for the health care industry.

Government services.

Even before any new health care entitlement programs and expansions, federal health entitlement programs are an economic disaster. Medicare Trustees note that the program has an unfunded liability of some $36 trillion over the next 75 years. As a percentage of GDP, expenditures are projected to increase from 3.2 percent in 2007 to 10.8 percent by 2082.

The lesson of 2008 may well be that we must ensure that federal, state and local governments renew their focus on cost-effectively achieving their fundamental missions of protecting citizens' safety and security. Government will no longer be able to perform numerous philanthropic and social functions that individuals and private associations can do for themselves.

Unfortunately, old ways of thinking die hard. For generations, and in both parties, American politicians have gained power by delivering new programs and services paid for with borrowed funds. Initially, these were raided from the Medicare and Social Security Trust Funds. More recently, funding has come from the sale of bonds to foreign investors.

The new Administration has embarked on a long, highly dubious attempt to return to prosperity by throwing hundreds of billions of newly printed dollars at myriad systemic problems in the health care industry, the housing industry, the financial services industry, the auto industry, the Congressional pork barrel industry, and many other enterprises.

But government has no ability to create demand; only the market can. Government does not create wealth, it can only redistribute it. Government does not create jobs; it can only delay the inevitable creative destruction in any free market. Furthermore, government "stimulus spending" inevitably leads to inflation.

The new Administration is signaling it will exacerbate the recession and its attendant problems by trying to hold labor markets of yesterday in manufacturing, health care and government along with their rich benefit structures.

Make-work jobs in infrastructure will not meet tomorrow's needs. In recent years, government statistics show that about 25,000 jobs are destroyed and created every hour that America is open for business. Rapidly evolving markets create dynamic labor markets.

American government at all levels from the local school systems to the federal are bankrupt.[5] Politicians are good at giving things away. They have no experience in restricting spending and eliminating programs.

Changes for health care.

As the new Administration greatly expands its funding footprint in health care, permanent entitlement costs will be in place without realistic sources for long term funding.[6] These new entitlement programs would be created using temporary "stimulus funding" based on borrowed money. Private health plans will be driven from the market; and we will be left with a hopelessly underfunded health care system with no options.

So far, we have few details of how health care policy will evolve under the new Administration. However, there are clear indications of Congressional thinking. The Senate Finance Committee is calling for massive increases in both Medicare and Medicaid. This "Baucus Plan"[7] will add between $200 billion and $300 billion to the $2.3 trillion we spend each year on government paid health care.

Medicare sets standards for 8,000 medical procedures and services at a 2007 cost of some $425 billion for people 65 or older, or about $10,000 per person. Under the Baucus bill, the age for joining Medicare would drop from 65 to 55. A healthcare system serving 44 million people would make 32 million more (4 million of whom are now without health insurance) eligible.

Medicaid will expand to cover every American living in poverty, rather than just the 61 million people it serves today. This could push 7 million people into the government program and add billions of dollars to its cost.

Finally, the State Children's Health Insurance Program, or SCHIP, will expand to cover all children with family incomes less than 250 percent of the poverty level - up to $53,000 for a family of four. That would add millions more people to SCHIP, which today costs $5 billion a year to cover 6.5 million children.

Put all this together and existing health care programs - Medicare, Medicaid and SCHIP - will be expanded, new healthcare regulation for business and individual policies will be established, and America will have a vast new healthcare program run for and largely paid for by the government. With little input from patients or physicians, government will run it, regulate it, supervise its performance, mandate how company participation in it, and somehow come up with more than several hundred billion dollars each year to pay for it all.

All these program expansions represent fixed future spending obligations. Given the revenue claims by existing social entitlements, there is no long term funding for these spending increases. It is difficult to find the pony in all of these data.

With expanding government health care financing, we can expect a decline in payment to providers compared to their rising cost for delivering services. Competing interest groups will clash for a piece of the spending pie. Highly politicized Medicare-like price controls on providers and services will spread to every health funding decision. The result will be rationing and declines in the quality of services.

Meanwhile, outsourcing of high end health care to international markets[8] is accelerating. There is a clear and present risk that high tech diagnostic and invasive therapy will migrate to international markets.

Formerly this competition came from distant markets in SE Asia and beyond. Now American hospital chains are starting to buy into Mexico. International Hospital Corp. in Dallas has 5 Mexican locations. Dallas-based CHRISTUS Health has built 6 hospitals in Mexico through its partnership with a Mexican chain. Procedures performed cost a third to two-thirds less than they would in America. People are coming from as far away as Alaska for bariatric, plastic and cardiovascular procedures, as well as knee and hip replacements. Many health insurers are adding cross-border facilities to their networks.

The future will unfold in one of two ways. Either we will deliver an affordable health care financing system in the private sector, or we will find health care thrust onto the political appropriating arena.

The former will require a series of dislocating changes. Innovation will become essential. Increased productivity will be the basis for the reward system. Health care labor costs, which are out of control,[9] will be reduced. Return to an intermediary free market will be unavoidable.

The latter is more likely. Industry inertia and the primacy of parochial interests will oppose dislocating free market changes. Costs will be controlled through shortages. Provider incomes will be dictated. Innovation will be suppressed. Organized criminal activity will increase as more limited funding is diverted into fraud. Americans with resources will seek care in the international markets and our best talent will go offshore.

As government power and resource move further into health care funding, we will find our ability to make our own choices about our lives, our families and the world around us progressively limited. These policies will ensure that more health care decisions are made - and more of our and our children's money is spent - by a progressively smaller group of policy makers who live far from our communities. They will care little about our personal preferences, religious convictions or personal aspirations. None of this could have happened without the failure we have witnessed in the private sector.

It is not a pretty picture.

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development and consulting firm.

1. Projections by the Center for Economic and Policy Research are based on the numbers in the 12/16/08 Case-Shiller home price index, which showed accelerating price declines in most big cities.
2. http://www.bloomberg.com/apps/news?pid=20601087&sid=aS0yBnMR3USk&refer=home
3. Primarily driven by the introduction of information technology into the workplace.
4. China has bought more than $1 trillion in American debt. Now the key drivers of China's Treasury purchases are disappearing.
5. For more on unfunded GASBY-45 benefits, see http://www.ssvms.org/articles/0809gibson.asp
6. PAYGO, the pay-as-you-go rule of fiscal responsibility mechanism self-imposed by Congress, is being ignored in the "stimulus" package.
7. Named for U.S. Senator Max Baucus (D-Mont.), Chairman of the Senate Finance Committee; http://finance.senate.gov/healthreform2009/finalwhitepaper.pdf
8. http://www.ssvms.org/articles/0711gibson.asp
9. Labor costs for professional services in health care are twice those of any other industrialized country.