Statement of

Glenn Melnick, PhD
Blue Cross of California Professor
Director, Center for Health Financing,
Policy and Management

School of Policy, Planning and Development
University of Southern California

On

Health Care Reform in California

Before
State of California
Little Hoover Commission

February 22, 2007

Health Insurance for All Californians:
A Good Idea But What Will it Really Cost

Overview

Governor Schwarzenegger and his team have proposed a bold and imaginative plan for reforming health care in California. The plan has as its centerpiece a requirement that everyone in California purchase health insurance coverage and an income based subsidy for families who cannot afford it to help them to purchase health insurance. This policy recognizes a basic fact – health care is expensive and not everyone makes enough to afford to buy health insurance protection. To minimize the financial effects on California taxpayers and businesses, the plan also includes very creative and complicated financing plan which purports to expand coverage to 6+ million uninsured Californians with little or no direct cost to the average person or business in California.

My testimony follows two themes.

I believe that the Governor's plan addresses a very important problem that must be faced and solved – growing numbers of Californians without health insurance coverage.

However, I am much less certain that the plan's strategy for financing this major expansion will work as suggested and that we are more likely to be faced with higher taxes in the not too distant future. While Californians may support higher taxes to ensure universal health insurance, I think it would be very valuable for the Littler Hoover Commission to take on as part of its investigation and reporting the following:

1) Develop a transparent and realistic 5 and 10 year financial plan that includes all the potential economic effects of the plan including the possibility that higher taxes on both individuals and businesses may be needed to fund the plan over the long run

2) Estimate how much of a tax increase would be needed under more conservative assumptions

3) Assess whether higher taxes might slow statewide GDP growth in the future.

Finally, the report might address whether it is economically feasible for a single state to achieve universal coverage or whether it must be done on a national basis.

There is a Need for Subsidized Health Insurance Coverage

A University of Michigan study in 2000 estimated that the average insured American will spend $316,000 on health care over their lifetime (half before they hit age 65). The total is closer to $450,000 when one factors in today's higher medical prices and administrative costs of health insurance. Not everyone can afford this. For example, someone who makes $10 per hour ($20^{th}$ percentile in CA) earns $20,000 per year or about

$800,000 over 40 years. Health insurance would be more than half of total earnings. Many families simply will not earn enough over their lifetimes to pay for all the essentials and have enough leftover to cover the additional cost of health insurance. While there are already two major subsidy programs for health insurance, MediCal and Medicare, they are no longer enough, as evidenced by the 6.5 million Californians without coverage. The Governor's proposal recognizes this economic reality and includes a new subsidy along with a requirement that all Californians purchase health insurance.

What Will the Plan Cost California Taxpayers in the Long Run

The plan's estimated price tag to California taxpayers of supporting a permanent subsidy, however, is probably far too low. In its current form the plan relies on too many favorable assumptions. For example, one assumption is that hospitals and doctors will charge lower prices to private insurance companies such as Blue Cross in the future -- since they will no longer have to provide free or highly discounted care to the previously uninsured population. In developing the plan, it was necessary to make an assumption about this since we have no research on which to base an estimate. However, there has been substantial research about health care providers and the way they price their services. It appears that they operate much like any other business -- they prefer to charge higher rather than lower prices when they can. This suggests that prices charged by doctors and hospitals to insurance companies are unlikely to be much lower in the future.

In fact, it is more probable that prices will rise, at least in the short run, as this large, newly insured population of 6+ million starts using their new health insurance cards, generating a surge in demand while supply is fixed. We are not going to see, for example, an immediate increase in hospital beds, doctors or nurses - just higher health care prices resulting in higher, not lower premiums -- for everyone.

Another element of the proposal is a mandate that employers either provide coverage to their workers or pay four percent of payroll into a state fund. This mandate will trigger all companies to evaluate how much they spend on health care as a percent of payroll and if it is more than 4 percent, some will make a rationale business decision to drop coverage and pay the new four percent tax. This will lead to reduced private coverage and more workers and their families in the state covered fund which will need to be subsidized by taxpayers. Another important assumption in the plan is that the federal government will provide an on-going, multi-billion dollar subsidy to California (and other states who would likely follow) to underwrite subsidized coverage expansion. Given the federal budget deficit, it is at least equally likely that congress will eliminate this financing source to the states.

While the Governor's proposal is noble in its aims, it must also be realistic and transparent in its financial planning. We are being asked to sign on for a long term commitment that is only likely to increase in scope and cost as time goes on, since health care costs in California will continue to outpace wage gains. As we debate this important issue in coming months we should keep in mind that policy makers, in their enthusiasm to enact new programs, often underestimate future costs and we should all work to make sure that we generate complete and accurate information on the true costs of the plan so that we can fully understand its full long term effects on both access to health care and on California's economy.

Glenn A. Melnick, Ph.D Professor and Blue Cross of California Chair in Health Care Finance at the University of Southern California (USC) and the Director of the Center for Health Financing, Policy and Management at USC and occasional contributor to this journal.