THE DEFICIT: AMERICA'S PROBLEM—MEDICINE'S CHALLENGE

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IF one could pick two topics likely to make an American audience cringe, one would be the federal budget deficit, the other would be soaring medical costs. This afternoon I have the perverse pleasure of addressing *both* topics in one talk. Unfortunately for you, my distinguished audience, the federal budget deficit and soaring medical costs are profoundly and unavoidably intertwined. Medical costs add to the deficit; the deficit brings pressure to bear on containing costs. I shall argue that the deficit is one of the most important issues facing the United States today. I shall point out that reducing the deficit will require sacrifices throughout society, including restraining government expenditures on health care. And I will try to convince you that if we do this right, it need not produce cruel rationing and social misery.

In the final analysis, how we as a nation resolve these interrelated issues will have a heavy impact on the quality of American life for years to come. That is why this symposium is so important. And that is why I am so pleased to take part.

Let us start with the federal budget deficit. As we know, it has grown in recent years to assume a larger and larger proportion of our nation's total output of goods and services. In 1985, for example, the deficit was 5.4% of Gross National Product, more than twice what it had been in 1981. During those four years federal debt held by the public nearly doubled—to $1.5 trillion. One consequence of this growth is that paying the interest on the federal debt has become increasingly onerous. Last year interest on the debt absorbed 17 1/2¢ of every tax dollar. That money never showed up in any federal program, it did not buy defense, or health care, or education. The 1985 budget deficit—at 5.4% of Gross National Product—represented roughly two thirds of net American savings, which is the principal source

*Presented as part of the 12th Symposium on Medical Education, *Government and Corporate Influences on Patient/Physician Relations*, held by the Committee on Medical Education of the New York Academy of Medicine March 6, 1986.

of capital for investment in productive capacity. Today our nation saves an average 8% of its Gross National Product. If the bulk of these savings are first directed to financing federal deficits, little is left to finance new investment in the private sector.

In recent years a massive inflow of foreign capital has supplemented our domestic savings. More than $100 billion worth of foreign capital flowed into the nation last year alone. Why did this money flow in? In part, it was seeking the higher interest rates our economy offers. And why do we have higher interest rates? Government borrowings to finance the deficit keep our interest rates high relative to inflation and relative to yields available elsewhere in the world. This drove up the value of the dollar, which in turn kept our exports from having competitive prices overseas and left us with a trade deficit of $150 billion. If we do not get the foreign capital, the government will usurp massive amounts of money that should go to productive investments, thereby slowing down present and future economic growth.

A serious risk of uncontrolled deficits is that foreign investors will lose confidence in this country as a desirable place to invest, and that the inflow of foreign capital will end. If the nation continues to incur massive deficits, these inflows—and our ability to sustain growth—could stop. Without growth we cannot finance even the programs we now have.

We are living on borrowed time. We have been spending more than we produce, making up the difference with imported capital. One thing one learns if one watches economic phenomena is that trends usually do not go in the same direction forever. This has been true for the price of gold; we have recently learned that it is also true for the price of oil. And the most recent drops in the dollar bring an ominous warning that foreign investors may be reaching limits on the U.S. investments they are willing to hold.

The existence of that massive deficit puts us in a difficult position: If we get the foreign capital to finance it, the dollar tends to be overvalued, and many segments of American industry are unfairly left out of our expanding prosperity.

The effects of budget deficits have not gone unnoticed. I am not the first to bring to the attention of a cringing American audience the horrifying picture of our federal budget deficit. All the right descriptions have been used—ballooning, mushrooming, spiraling, bloated. Nothing can be added to the current lexicon of deficit descriptions, and I shall not be the first or the last to point out that the deficit is too big. Because of growing awareness of the problem, the entire spectrum of government spending has undergone intense

scrutiny. This objective has been, I think, universally applauded, although so far it has yielded few tangible results. In fact, aggregate federal spending as a percent of Gross National Product is higher now than it was five years ago. Passing the curious Gramm-Rudman-Hollings budget act was a step in the right direction, but much more needs to be done.

One way to eliminate the federal deficit is to raise taxes, and I believe that some increases are called for. But there is a limit to the amount a country can tax its people before initiative and the incentive to invest are severely curbed. When viewed in terms of encouraging investment and growth, the United States appears to have a more desirable level of taxation in relation to current income than Great Britain, West Germany and Sweden, whose health care systems are more comprehensive than ours. During the economic recovery of the past three years, tax receipts in the United States were equal to 31% of Gross National Product versus 42% for Great Britain, 45% for West Germany and 59% for Sweden. Over this period American economic growth averaged 4.3% while those European countries had an average growth rate of 2.6%.

Though higher taxation was not the only reason for lower growth in these countries, it does seem to have limited their expansion, and the data do agree with our historical experience: higher taxes tend to dampen economic growth, and that diminishes the nation's capacity to improve its people's quality of life. Moreover, aggregate growth in all of the industrialized nations, including Japan, has been slower during the last five years than during the earlier postwar period. There are a number of reasons for this, but the objective now, for the sake not only of those countries but poorer countries who sell their goods to the West, must be for more growth. Rising general levels of taxes will impede the growth that is needed.

Clearly, most of what we have to do to get our fiscal house in order is to cut back on federal spending. If we do not, we might wind up like New York City, whose fiscal affairs were so botched during the 1970s that only a major crisis and draconian responses could save it. The real lesson from the New York City crisis is that we have a choice as to how economic and financial imbalances will be rectified. We can wait until crisis overwhelms us, demanding massive adjustments. If things go that far, of course, our options will be limited and the sheer size of the required adjustments will dictate sweeping cuts that would wreak havoc with our social and human priorities. *Or* we can recognize the problems before they reach crisis proportions, and cooperate intelligently to contain fiscal excesses while we still have ade-

quate resources to meet society's needs. While I regard our budgetary problems as extreme, I do believe that we still have the time to reduce the deficits in a systematic way.

With this background, let me turn to what I consider the challenges and opportunities confronting the health care industry as part of this overall effort. As we all know, there has been enormous growth in this activity over the last 20 years. Health care is now a billion-dollar-plus per day industry in the United States. In 1965 health care expenditures accounted for 6% of Gross National Product. Today they account for 11% of the nation's output. This growth has occurred for a variety of reasons. In part it resulted from government programs, which extended the availability of health care to the poor and the elderly through Medicaid and Medicare. Individuals—as their purchasing power has grown—have chosen to spend more on health. Over the last two decades real consumer spending for health care has increased 250% versus a 172% increase in overall consumption spending. This is good. We would all agree that this shift of spending priorities has made us healthier and is a mark of a civilized society.

Yet, during any period of dramatic growth, inefficiencies are likely to appear. We have seen it in the defense build-up, and it is no less evident in the growth of the health care establishment. One manifestation of inefficiency is found in the inflation statistics. For the past 20 years the rate of inflation in health care has persistently outpaced the rise in the overall price level. And the disparity is growing: the rate of consumer price inflation during the past five years declined sharply, to a 5 1/2% annual rate from almost 9% during the preceding five years. The increase in health care costs, however, has barely slowed—to 8.7% annually between 1980 and 1985, from 9 1/2% from 1975 to 1980.

While this disparity in inflation rates suggests a problem, it also represents an enormous opportunity. If we can slow the increases in medical prices, we can save dollars and at the same time preserve or conceivably even *increase* the real consumption of health care services.

The fact is, both government and private insurers are having to finance inflation along with needed medical care. As president of a company with nearly 20,000 employees, I have seen soaring costs in privately financed care—where insurance once designed to protect employees against catastrophic illness has been broadened to cover nearly complete care. The result is that many employees of modern corporations are never troubled by payments for medical care at all, and therefore can never participate directly in the efficient allocation of resources.

It is one thing to expand health services and their availability to all sectors of our population—this is truly the "great society." It is quite another thing, however, to expect the economy to allocate scarce resources to pay for spiralling costs that go way beyond the expansion of real health services. This must change if we are to get good value from the resources devoted to medical care, and it must begin to change fast if we are not to risk the constituency for better and more available health services for our people.

As I view it, therefore, our challenge is to make delivery of medical care more efficient (by rationalizing services and containing costs) while still preserving the critical parts of health care that can only be supported with government programs, and while reducing the federal budget deficit.

Can we do all this? I believe that we can. The fairest and most logical solution would combine both reducing the overall level of federal spending and the introduction of market discipline in the delivery of health care. We must get the consumer of medical care more actively involved—choosing according to price and need for services. Moreover, we must give incentives to providers of care to make the process more efficient. Putting some market discipline back into the health care process is the best way to reduce costs without reducing services. Examples of what the market can do are found in other industries that have been deregulated and returned to a market pricing discipline. To cite just one, airline deregulation has caused a tremendous increase in air travel availability, largely at lower cost to passengers. There have been problems with deregulation, of course. Staying with air travel: certain communities have been hurt and large numbers of airline employees have been affected adversely during the transition. Moreover, an important public policy concern has been adequate air traffic control in the face of greater crowding of the skies.

In health care, too, the most important public policy concerns must not be ignored. In my opinion, much attention must be given as we evolve to a more efficient system through greater market discipline to two overriding issues: First, in a society in which a large number of people are poor, we must provide means for them to have access to health care services. This means actually expanding government involvement, but if this is not to add to cost pressures and inefficiency, I would suggest that programs for the poor should be targeted to them without compromising the desire of giving back to the larger numbers of our people a measure of financial responsibility for their health care costs. Second, it seems to me there is a special role for government in financing at least the earliest stages of basic research. This is where the breakthroughs for the future will be germinated, and something

beyond supply and demand in an open market is worth preserving and enhancing. Perversely, it is these two most legitimate involvements of government that are most in jeopardy. Growth in research funding has slowed in recent years, and President Reagan has proposed a cut in his 1987 budget. Furthermore, an estimated 15% of our population still has no access to either public or private health insurance programs.

This points up the crying need for a better way of dealing with overall health care costs. Without better ways of rationalizing and economizing throughout the system, we run the risk of forced solutions that none of us will find acceptable.

The delivery of comprehensive and expanding services with a smaller health care budget is a formidable challenge. With the deficit looming and budget cuts necessary and unavoidable, we must accept and welcome increased reliance on market discipline. The market has already responded, providing the consumer with a wider variety of delivery systems and financing alternatives. And we must do more—in the design of public and private health insurance systems—to get consumers involved in the health care decision process.

There is a growing recognition that consumers of health care should play a more active role in influencing the nature and cost of the services they use. This inevitably means that many individuals will have to start paying more, but I believe that this will have benefits. As more people pay some portion of their routine care, we as a society should derive some of the beneficial effects of the market-system in the delivery and cost of health care in America. This should bring about greater discipline, efficiency and productivity per dollar spent.

In conclusion, I shall simply reiterate that, in my view, government must be counted on to assure basic care for the poor and elderly—no matter what. And I believe that the government also has a particular role in fostering the most basic research. Beyond these requirements, we must search for more ways to reintroduce the judgment of individual consumers into the process of delivering health care services. I am convinced that our citizens will make the right choices, and that we can truly move to a resolution of the present cost problems while continuing the enormous health care progress we have made in recent decades.