Why Healthcare Premiums are Taxes

Introduction

I would not be contributing anything novel by asserting that "Healthcare costs in America are really high". Many have already read the statistic that the US spends 18% of its Gross Domestic Product ("GDP") on healthcare while other European countries spend only 10-12% (Statista Research Department, 2023). However, these healthcare costs are eating into Americans' paychecks and potentially even pricing them out of jobs (Case and Deaton, 2020). My belief is that many, on the left and the right, are thinking about solutions to skyrocketing healthcare costs in the wrong way.

Many on the left conclude that because the US does not to have universal healthcare, its healthcare costs are much higher than its European counterparts. On the other hand, those on the right may blame high healthcare costs on the government for interfering in the free market. Both of these viewpoints miss out because there are no magic bullets in healthcare. Let's briefly discuss universal healthcare. By nationalizing health insurance, universal healthcare would require that everyone be covered which all else equal, will increase costs as the uninsured population, 8-10% of the US population (Ruhter, et al, 2021), would now receive healthcare. However, "all else" would like not be equal, there are potential savings from nationalizing health insurance. Savings could come from a reduction in administrative costs and elimination of insurance profits. The savings would need to far outnumber the increased costs of insuring every American for universal healthcare to make a sizable dent in our high costs. As for the right's love of free markets, free markets work best when there is perfect competition and health insurance is not an application where perfect competition plays out. One's health is in theory priceless and they would therefore pay as much as they possibly can afford to preserve it. With a seemingly unrestricted free market, you can see insulin prescriptions cost upwards of $300 per month (Cefalu et al, 2018). Insulin is a lifesaving drug for Americans with Diabetes which is over 10% of the population (CDC, 2022). In addition, prices in general are raised due to synthetic demand created by insurance. Since insurance companies have deep pockets and are contractually obligated to cover insulin and other healthcare costs, health providers can charge high prices. My thesis is not that universal coverage or adding more competition to US healthcare are bad ideas. The US healthcare is flawed but the main flaw to me, seems to be underlying prices that providers charge.

Healthcare Premiums and Taxes

It is very American to dislike taxes. For that very reason it has confused me why politicians do not characterize healthcare premiums as taxes when campaigning on Universal Healthcare or other proposals to bring down healthcare prices. Conservatives do not hesitate to criticize

government programs for increasing taxes. However, why can the same not be said for unchecked business interests? When looking at the top lobbying firm spending in 2022, I became less confused. In the table below you can see that Pharmaceutical Research, the American Hospital Association, Blue Cross / Blue Shield, and the American Medical Association are all in the top 10.

Table 2.1: 2022 Top 10 Lobbying Firms by Dollars Spent	
Institution	**Total Spent ($ Millions)**
National Assn of Realtors	81.7
US Chamber of Commerce	81.0
Pharmaceutical Research & Manufacturers of America	29.2
American Hospital Assn	27.1
Blue Cross/Blue Shield	26.9
Amazon.com	21.4
American Medical Assn	21.1
Business Roundtable	20.4
American Chemistry Council	19.8
Meta	19.2

Source: OpenSecrets. (n.d.). *Top spenders*. OpenSecrets. Retrieved March 8, 2023, from https://www.opensecrets.org/federal-lobbying/top-spenders?cycle=2022

Healthcare inflation, the rate at which medical goods and services increase per year, is generally higher than the aggregate CPI in the US. This in turn means healthcare claims will grow each year more than general inflation. These healthcare price hikes are passed onto the consumer through higher health premiums each year and are shared by employers and employees. The individual's contribution is deducted from their paycheck similar to how taxes are withheld. Further the fact that the employer covers some of the healthcare premium is troubling. Not because they are providing the benefit but rather because it increases the cost of employing the individual. When budgets tighten, higher healthcare costs make workers more expendable from the corporation's perspective. The same way stricter regulations and higher taxes allegedly do. Further, put another way, the high healthcare premiums are included in its total compensation provided to employees. However, an additional dollar of healthcare premiums is not the same as an additional dollar of wages. Therefore, all else being equal and ignoring tax benefits, healthcare premiums are dollars that could have been disbursed to you the individual as wages. There is also the argument from the corporation's perspective that these excess healthcare premiums could have been distributed to shareholders to increase the stock price. However, we will leave the capital vs. labor struggle for another day.

Now one must ask the question how do we bring healthcare premiums down? One may instantly blame the insurance companies for charging too much premium. However, insurance companies are not fully to blame. Per the Affordable Care Act, the insurance company cannot realize a loss ratio of lower than 85% for group health insurance (Skwire et al, 2021). The loss ratio is equal to

benefits divided by premiums with some ACA specific adjustments[1]. Put another way 15% of premiums can be used to cover profits and expenses. The provision is a little bit more complicated than this, but we will run with the 15%. This means if the US were to nationalize healthcare and realize loss ratios of say 95%, by removing profits and assuming 5% would be allocated to expenses it would not cut premiums by enough to normalize US healthcare costs relative to our European counterparts. Assuming benefits did not change it would lead to a reduction of premium by roughly only 10.5% (1-85%/95%) which is by no means insignificant but only makes a dent in the aggregate whale. For reference, a 33% reduction brings the US to roughly 12% healthcare spending as a percent of GDP using simple math. This is because health benefits are the driver of healthcare premiums.

Let's make one thing clear, I am not defending health insurance companies. They are by no means these ethical institutions simply doing what the market tells them. Further, they benefit from higher benefits because it leads to a higher premium for which they can take their 15% cut from. One could make the case that they are complicit in high healthcare costs. One example is the fact that the largest pharmacy benefit managers are owned by health insurance companies. For example, CVS Health owns Aetna (30% market share), Express Scripts is owned by Cigna (23% market share), Optum Rx is owned by UnitedHealth Group (23%) and Humana owns a PBM called Humana Pharmacy Solutions (7% Market Share) (Paavola, 2019). These four firms are 83% of the PBM market. PBM's administer prescription drugs programs and negotiate drug discounts from manufacturers. Based on PBM's fee structure, PBM's benefit from surging drug prices (Skwire et al, 2021).

Another potential area for savings is the reduction in administrative expenses. There are two conflicting arguments here. Under a universal system, everyone would be covered under one insurer and therefore the administrative expenses would be relatively lower thanks to scale. This argument is for government healthcare and is a direct slap in the face to libertarians. The libertarian side will argue that the private sector is always more efficient than the public sector because the bureaucracy of the government leads to inefficiencies. While perhaps this is true in some cases, this statement must be backed with data. To quantify this disparity, I estimated the percent of expenses relative to total expenditures for the public sector and the private sector. I used Medicare expenses to proxy the public sector and the 2021 NAIC health insurance report aggregate financials to proxy the private sector. Based on the 2022 Medicare Trustees' report $10.8 billion were allocated to administrative expenses (MBOT, 2022). This equates to 1.3% of the total expenditures. Per the NAIC's 2021 report, total administrative expenses were $103 billion which equates to 11.7% of total expenditures. One could dispute these elevated private sector expenses as a result of Covid-19. However, the ratio of expenses to expenditures in 2019, before the pandemic, was 12.2% (Rivers et al, 2022). Some factors explaining this observation could be that Medicare spends less on adjudicating claims, has relatively less overhead, few marketing costs and no commissions. In health insurance it does appear that bigger is better in terms of administrative expenses which supports the argument for universal healthcare.

[1] The ACA adjustments include adjustments for the risk adjustment mechanism, quality improvement activities, credibility and fees plus taxes among other things.

Competition

In this next section we will explore the impact of competition on healthcare spending. Often times people will argue that our healthcare industry simply needs more competition in order to bring prices down. These beliefs are rooted in the perceived effectiveness of the ability of markets to allocate resources. However, healthcare is nowhere close to a perfectly efficient market. Health is priceless and therefore people will pay as much as they can afford to stay alive which can lead to price gouging. As a throwback to supply and demand curves from economics classes, the demand curve would be close to vertical indicating price is not a factor (also called price inelasticity) in purchasing decisions because some medical services are a necessity. This indicates that providers can charge high prices for life saving drugs, services, operations, etc. and unfortunately, not everyone can afford these prices. In addition, insurance ironically pushes prices upwards as well. Unsurprisingly, insurance companies have more resources than an individual. Therefore, insurance gives policyholders a means to afford more expensive prices. In turn, healthcare becomes more price inelastic and allows providers to charge higher prices. The catch is over time, these increased prices must be covered by higher premiums.

A specific example of how competition can hurt markets is the Affordable Care Act's exchanges. The ACA developed state exchanges for those without health insurance (Skwire et al, 2021). In these exchanges, policies are grouped into 4 classes; platinum, gold, silver and bronze plans. These categorizations are based on how rich the benefits the plan provides. Richness is defined as the degree of cost sharing included in these plans (e.g. copays, deductibles, etc.) (Skwire et al, 2021). The ACA markets provide subsidies to low-income enrollees. In the paper, A hard pill to swallow: Appreciating the mathematical dynamics of the Affordable Care Act, Fann discusses the unintuitive aspects of ACA exchanges. One specific example is that more competition can lead to higher premiums for low-income individuals. The ACA subsidy is based on a benchmark silver plan and is calculated as the benchmark silver plan less a maximum contribution amount (Fann, 2020). The maximum contribution amount is fixed based on an individuals' income for those with incomes between 100-400% of the federal poverty level (Fann, 2020). Therefore, when the silver plan's benchmark decreases due to more competition, the subsidy will decrease as well by the same amount. In turn, the premium payable by low-income enrollees for other plans (Platinum, Gold, and Bronze) will increase due lower subsidies (Fann, 2020). Now some may argue that the ACA should be eliminated all together because it is an anti-competitive government intervention. However, the point of this example to show that competition will not magically decrease prices.

I am not arguing that that competition is bad. In the next section, I will point to many anti-competitive practices that increase prices. My point is that healthcare is too complicated for generalized statements. As discussed, increased competition can increase premiums in the ACA for low-income individuals, the very population the ACA was designed to help. Further, unregulated competition is not justified by the potential for abuse given the nature of healthcare. In recent news, Eli Lilly reduced Insulin prices to $35 a month. This was done either out of their concern for the public good or the Inflation Reduction Act's upcoming cap on insulin prices.

Scenario 2 sounds more realistic, and is by definition anti-free market contradicting the claim that only the free market can bring down prices. As such, I believe that more nuanced positions are needed. Some policies promoting competition will decrease prices but reliance solely on competitive markets is not a reasonable solution.

Monopolies

As discussed in the introduction, prices are key problem in the US. These prices are partially driven by anti-competitive behavior. As you will remember, I argued that competition will not always reduce healthcare costs. While this has its place in some contexts, it does not hold in all applications. The anti-competitive examples I will explore in the US healthcare industry are pharmaceutical company patents and hospital consolidations.

We will begin with patents. Patents are meant to allow the holder exclusivity in selling their invention. In healthcare, patents are most applicable to the pharmaceutical industry. The rationale for patents is that extensive costs for research and development and time for regulatory approval were needed to bring these drugs to market (Hagan, 2021, Pharmaceutical patent regulation). They will further assert patents are needed to incentivize innovation. While these arguments are likely true to some extent, patents are not without tradeoffs. Patents allow the holder to charge monopoly prices because by design, patentholders are the only player allowed to sell their product. Patents last 20 years but can be extended through controversial techniques. Pharmaceutical companies extend their patents by patenting slight adjustments to their products ("Evergreening"), litigation against competitors ("Patent Thicketing") or withdrawing the original drug and patenting a new similar drug ("Product Hopping") (Hagan, 2021, Potential Abuses). Thus, pharmaceutical companies can continue to charge monopoly prices for longer than 20 years. Further, the characterization that pharmaceutical companies as victims of years of R&D costs and regulatory burden should be challenged as well. It is estimated that big pharmaceutical companies spent $36 billion more on sales and marketing than on R&D per 2021 AHIP analysis (AHIP, 2021). The question becomes if they are so strapped for cash and time due to effort of seeking approval of their drugs, how are they able to allocate so many resources to sales and marketing? While abolishing patents all together is likely not a reasonable solution, a balance must be struck. Patents appear to be a driver as to why prescription drugs price increases tend to greatly outpace general inflation (Waxman, et al, 2017).

In addition, the effectiveness of pharmaceutical companies should be disputed as well. The biggest example is the opioid epidemic which started shortly after Purdue Pharma's opioid OxyContin was approved by the FDA in 1995 (McGreal, 2019). Purdue Pharma falsely marketed OxyContin as non-addictive due to its slow-release formula (McGreal, 2019). Following the approval of OxyContin, there was a rise of drug overdoses in the early 2000s. After the dangers of this drug became well known, restrictions were placed on prescribing. Unfortunenately little was done to treat those already addicted and this led to people turning to the black market for heroin and most recently heroin's deadlier cousin fentanyl (McGreal, 2019). Drug overdoses are

a key driver, perhaps the main driver, explaining the infamous trend of increasing American mortality in the 21st century as highlighted by Case and Deaton (Case & Deaton, 2020). While Purdue Pharma, does not distribute heroin and fentanyl, the company was responsible for millions becoming addicted to opioids. Further, distribution was particularly concentrated in rural communities in Appalachia where many of the jobs were offshored thanks to globalization. For example, in West Virginia prescribing of opioids was 300-600% above the national average (McGreal, 2019). While Purdue Pharma, has faced legal trouble, these lawsuits appear to be simply a cost of doing business (McGreal, 2019). As such they accrued billions in profits off the backs of poor people.

We will now return to the argument that big bureaucracies lead to inefficiencies. As you will remember, I disputed this argument in regards to private "competitive" health insurance being more efficient than universal health care based on the administrative expenses of Medicare compared to the commercial market. On the other hand, the string of hospital consolidations since the 1990s have increased healthcare prices which disputes the belief bigger is better. In the Health Care Project Pricing Project study, researchers found that hospitals with a monopoly (defined as no competing hospitals within a 15-mile radius) had 12.5% higher prices than those without a monopoly (Cooper et al, 2018). Private equity has fueled some of the consolidation and deployed $79 billion in 2019 alone in acquiring health care companies (Saliba, & Morgenson, 2020). Proponents will argue that by consolidating, hospitals can increase efficiency which will decrease prices. However, this does not appear to be the case as cost-cutting measures are often paired with price hikes (Saliba, & Morgenson, 2020). For example, TeamHealth which is owned by Blackstone Group, runs many emergency care departments in hospitals. These emergency room departments appear to be charging prices well above the median charge for emergency room services (Saliba, & Morgenson, 2020). In addition, TeamHealth was found to be aggressively suing poor people for unpaid emergency services (Saliba, & Morgenson, 2020). This is a clear example of taking advantage of the health is priceless relationship.

The Real Enemy

Based on how healthcare works, premiums will rise in line with the underlying prices of the healthcare services that the policies insure against. Higher premiums will cost individuals and employers more which will eat into wages the same way that taxes do. While it does appear that universal healthcare could improve prices by eliminating the profits and reducing administrative expenses, the subsequent reduction in premiums appears to be around 10-15%. This is by no means insignificant but there would be an additional cost of insuring everyone who currently does not have coverage which will offset some of the savings. If the US wants to bring its 18% of GDP health expenditures down to say 12% it would need an aggregate reduction of 33%. This must be done by reducing the extremely high prices currently being charged in the US. As such the enemy is the prices.

Pharmaceutical companies are allowed to make billions from monopoly drug prices thanks to the patent system. This is despite the fact that they dumped lighter fuel on the wood that would start the opioid epidemic. This opioid epidemic now appears to exceed the magnitude of AIDs in terms of deaths per year. To add insult to injury, the pharmaceutical companies targeted poor communities that were already dealt a large economic blow from offshoring. The investment firms are also to blame as these firms benefit from price inelasticity of healthcare. Price does not matter for someone in desperation. This makes buying up hospitals a great opportunity to price gouge, especially when regulators lack teeth. Perhaps worst of all, the sheer amount that the US spends on healthcare does not translate into better health outcomes. Rather, the US has stagnated in terms of life expectancy relative to other countries, even before the Covid-19 pandemic.

I hope after reading this you believe that the underlying costs need to be reduced in order for the US to reduce healthcare premiums. Universal healthcare is not magic. While European countries generally have universal healthcare and spend significantly less than the US, their insurance funds (whether set up by the government or by their employers) also don't have to pay the high prices seen in the United States. When premiums are seen as taxes, one can see that the increases are driven by healthcare cost increases. These taxes are then payable to a bureaucratic health care industry as the premiums are ultimately disbursed throughout the healthcare industry. In turn these taxes fund lucrative profits for rent seekers and the rest of us Americans become poorer.

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