

Economic Growth Program and Next Social Contract Initiative

Pay More, Get Less

How American Socio-Economic Policy Is Falling Short

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The American middle class faces an uncertain future. Staring headlong into a difficult – and changing – world economy that has yet to fully recover from the Great Recession, many middle class families are trapped between low, stagnant wages and an increasingly expensive set of social and economic supports.

A social contract of basic services and economic protections is needed to support workers amidst the ups and downs of a volatile wage labor economy. Ensuring affordable access to these basic goods and services for all Americans complements wage increases in boosting living standards and sharing the gains of growth across the population.

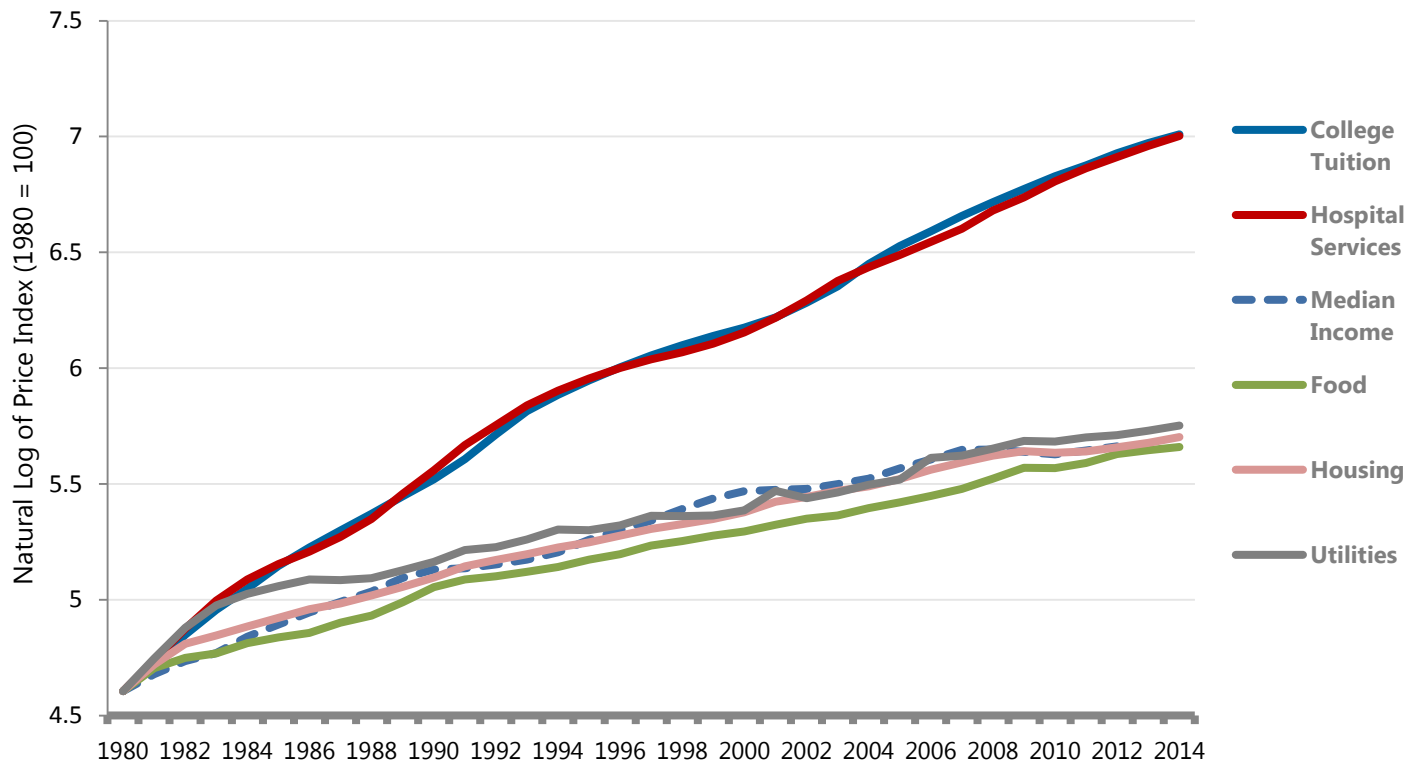
Yet wages and incomes for many workers are barely growing or even declining. Real household income is at the same level as it was in 1995,¹ and the labor share of income has declined nearly 15 percent since the end of World War II – the result of policy decisions, technological and geo-economic changes, and the transformation of workplace norms and business models.²

Meanwhile, although certain material goods have become cheaper over the years, the costs of the key elements of the social contract have not. Prices for health care, higher education, retirement, and other necessities have steadily increased for individuals, who now also bear more responsibility for paying for them. Toasters and computers may have shifted from luxury goods to standard household items, but a safe retirement, an affordable postsecondary education, and more are moving further out of reach.

The amount we spend on these programs stands out, but the benefits we enjoy do not. The US pays twice as much as a share of GDP on health care than the average of peer countries for the same or worse health outcomes – despite having

Growth in Prices and Median Income

United States, 1980 to present



Source: Author analysis of Bureau of Labor Statistics and Census Bureau data

the largest GDP in the world. The US spends more than anywhere else for higher education, yet is falling behind in how many students we educate and the academic quality of many of our colleges and universities. The US has a high cost of basic banking and retirement services, yet most people face ever more uncertain savings and retirement pictures. And even the Internet, which has become more central to both civic and economic life, is more expensive in the US than in many other OECD nations but looks like a tortoise compared to many comparable systems around the globe. According to the 2014 Social Progress Index, the US ranks 36th in the world in “foundations of wellbeing” – a catchall that includes education, health, and information services.³

Taken together, many of America’s domestic social and economic programs cost more money than those of other peer countries, yet we get worse outcomes and have less universal access. In other words, we pay more, but get less. Effective design is crucial to making these programs affordable and efficient for all, especially in the context of a difficult economy, but the current structure of many American policies has instead contributed to high and rising costs.

The pattern of “pay more, get less” is not reserved to any one part of the social contract – it is a pervasive feature of the entire American economic and social policy landscape. And this costly pattern has become a roadblock for expanding key policies to improve the quality of life for the majority of Americans.

The Wide Range of Pay More, Get Less

HEALTH CARE

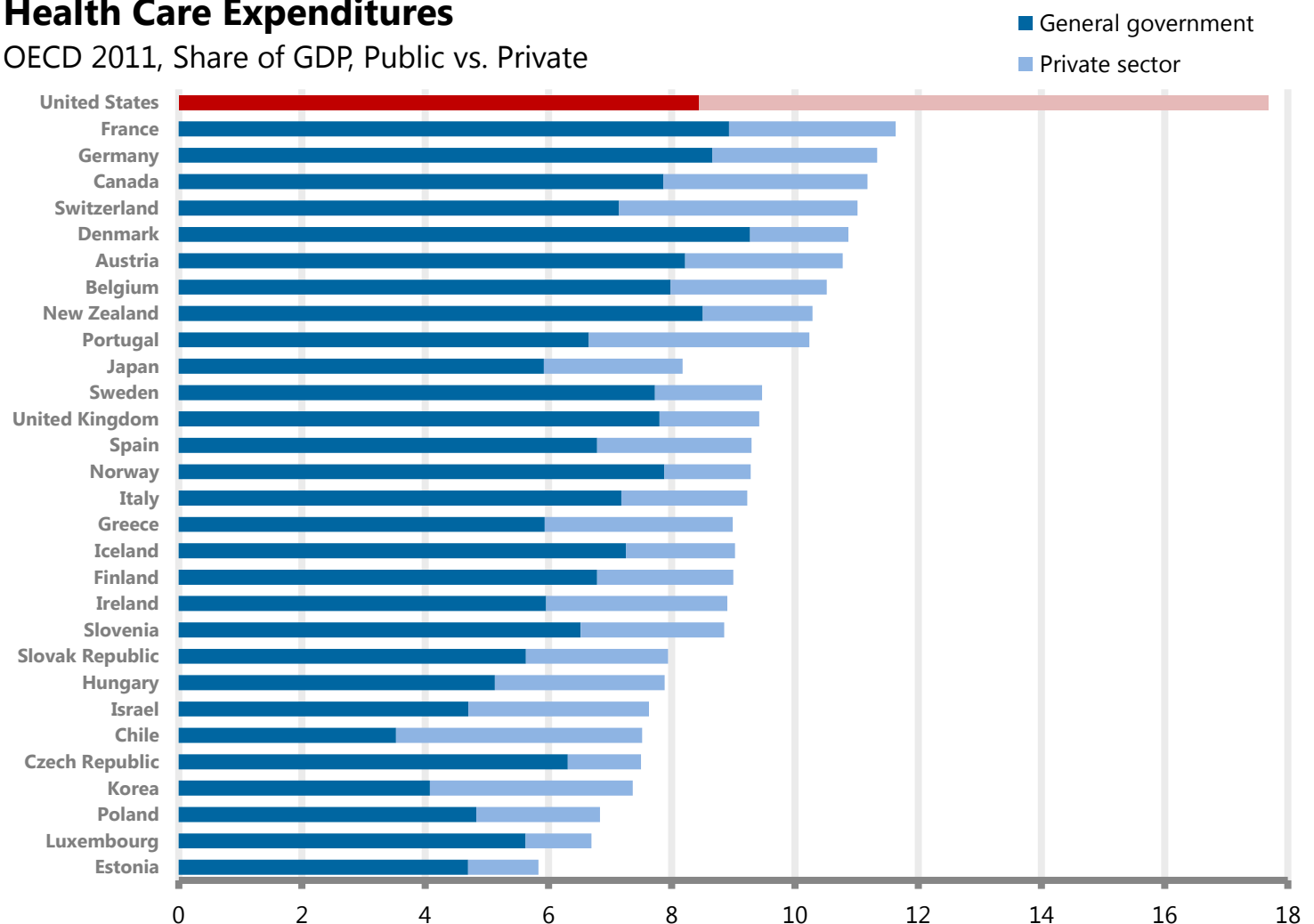
Affordable, effective health care services are the cornerstone of social policy programs, as they allow individuals to live longer and better lives.

The United States spends twice as much on health care as a share of GDP than the OECD average and more than any other country. Health care costs have increased almost twice as fast as wages since 1980, and hospital-related costs have increased four times as quickly. Health care costs slowed slightly after the Great Recession and as some provisions of the Affordable Care Act were implemented, but they have begun to increase rapidly once more – primarily because some of the reasons for the slowdown in health care costs were unrelated to the new legislation.⁴ In many cases, health care benefits put additional downward pressure on wages as employers responsible for providing health insurance limit wage increases to keep up with health care expenses.⁵

Compared to similar countries, the US's *public* expenditures on healthcare are high, but not that far beyond OECD

Health Care Expenditures

OECD 2011, Share of GDP, Public vs. Private



Source: OECD, Total expenditure

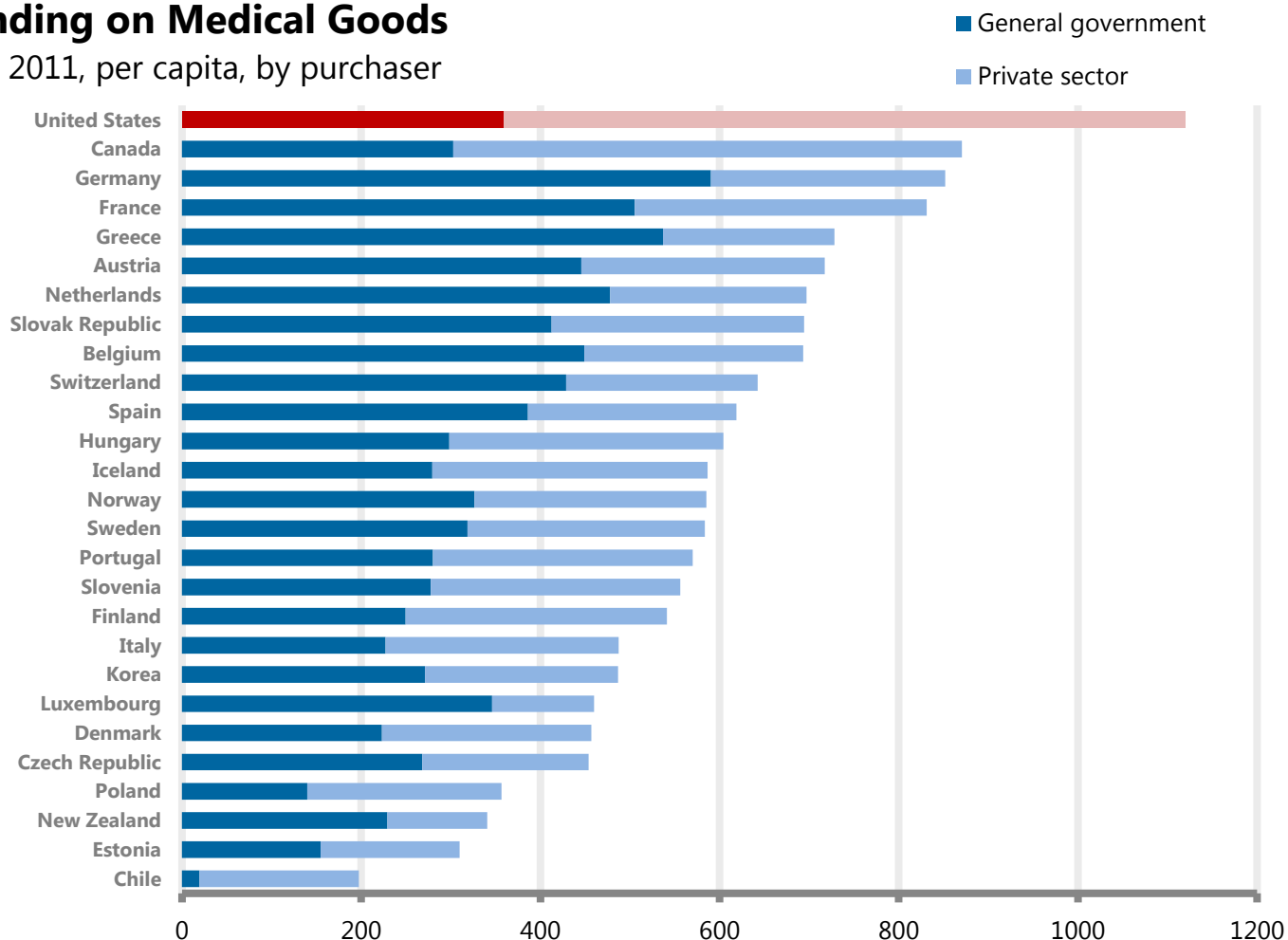
standards. In 2011, the US spent 8.45% of GDP on public healthcare expenditures, above average but below the share spent by countries like Germany and France. However, where the US stands out is in private healthcare spending. The US spent an additional 9.23% of its GDP on private healthcare costs; among the 28 other OECD countries reporting data, the next largest private health care spender was Chile, with less than 4% of its GDP. Together, the combination of public and private health expenditures in the US added up to nearly 18% of GDP in 2011.⁶

Two categories in which the US pays more are healthcare administrative expenditures and spending on pharmaceuticals and medical goods. US private healthcare administration and insurance costs were \$354 per capita in 2011. The country that spent the next largest amount on private insurance and health administration, France, spent only \$136 per capita (adjusted for purchasing power parity). On medical goods, US public expenditure per capita was about average (\$359 vs. \$326). But the US spent an additional \$760 on the private side, versus an OECD average of just \$268. As a result, US expenditures on medical goods were much higher than that of all other peer countries.

The extra spending goes all the way down to individual procedures and drugs: an MRI costs \$1,145 on average in the United States, compared to \$138 in Switzerland and \$350 in Australia. Nexium, a common medication for acid reflux, costs \$215 on average in the US but only \$20 to \$60 in parts of Europe. And the cost of spending one day in the hospital in the

Spending on Medical Goods

OECD 2011, per capita, by purchaser



Source: OECD, Total expenditure, Medical Goods

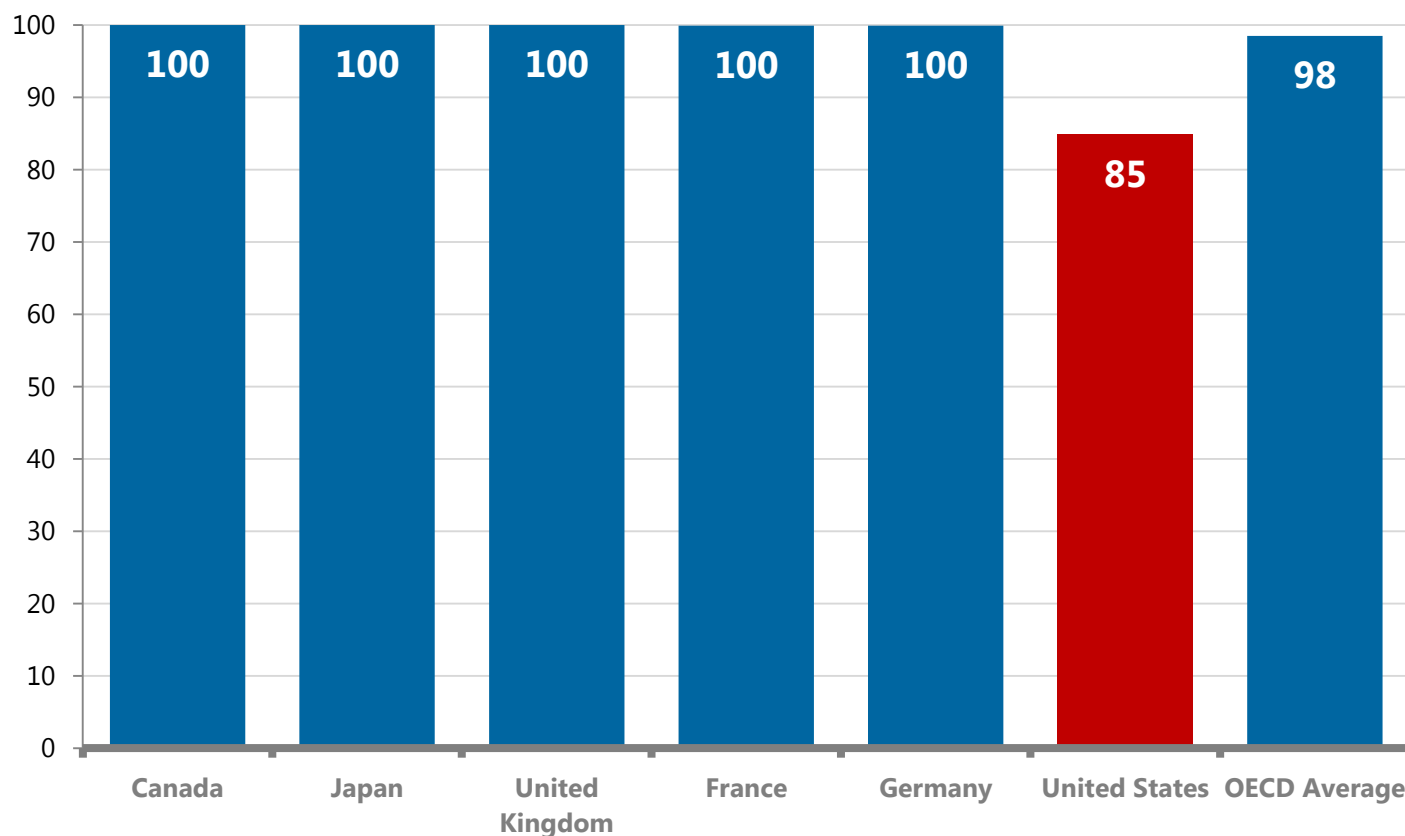
US is about 10 times higher than in Spain and three times higher than in Australia.⁷

Yet despite all of this health spending, the US covers a far smaller portion of the population. Nearly all OECD countries have universal health care coverage, for an average coverage rate of 98.5% of the population.⁸ Only 85% of the US population is covered by some type of health insurance, the lowest in any OECD country. With the implementation of the Affordable Care Act, this number is likely to rise; however, it is impossible to determine how many people who have gained health insurance under the new law were previously uninsured. Even using generous estimates, the level of insurance coverage in the US remains below 90%.⁹

Nor does the US spending translate into better “results” in terms of health outcomes. The US has an infant mortality rate above the OECD average (6.1/1000 vs. 4.1/1000 in 2011), fewer hospital beds (3.1/1000 vs. 4.8/1000), and lower life expectancy (78.7 vs. 80.1). People in the US are more likely to die during their prime working years from non-communicable diseases like cancer, heart disease, or diabetes than in 31 other countries, including Slovenia and Costa Rica.¹⁰ Despite complaints of long waiting lines elsewhere, the data suggests otherwise. A sick individual is less likely to see a doctor in the US than in the average peer country: the US has fewer doctor consultations per person than the majority of peer countries.

Share of Population with Health Insurance

OECD, 2011



Source: Health Insurance Coverage for a Core Set of Services

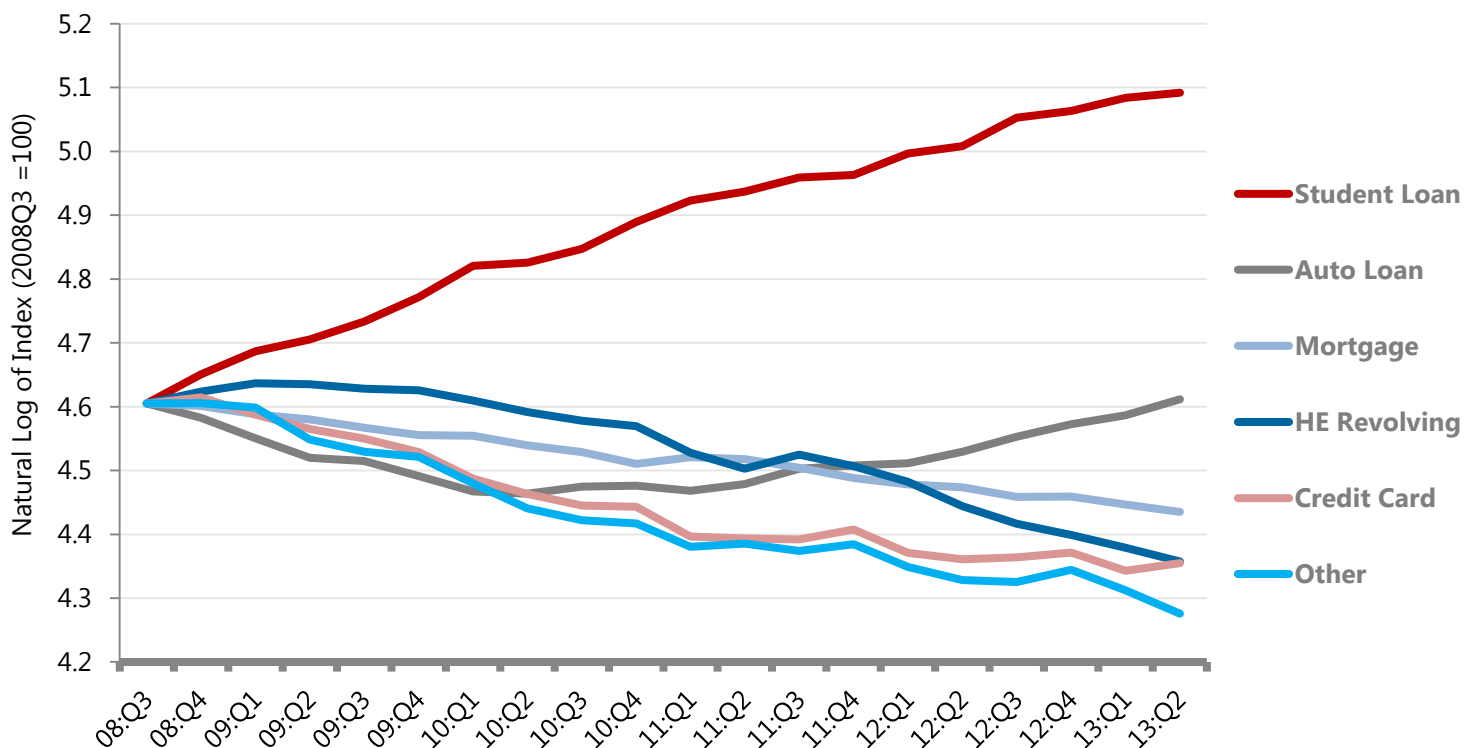
HIGHER EDUCATION

Postsecondary education of one form or another – vocational training, additional skill certification, or two- or four-year academic learning – has become a standard requirement for many employment opportunities, not to mention a pathway for personal fulfillment and building long-term human capital. Yet the push for expanding access to college has run headlong into rising costs that restrict access but do not necessarily contribute to a better education.

The higher education cost picture is nearly identical to that of health care. The U.S. spends far more on higher education than the OECD average and more per student than any other country. The US spent \$22,744 per student on higher education in 2010, while the OECD average was \$9,274.¹¹

As college tuition and fees continue to rise and state subsidies decline, an increasing share of the cost of higher education is being covered by individual students, supplemented by a variety of student loan subsidies, grants, and scholarships. Average student debt for undergraduates who have taken out loans is \$29,400, and the share of students borrowing increased from 53.5 percent of students in 2003-04 to 61.6 percent in 2011-2012.¹² Nearly 70% of graduates of public universities have student debt.¹³ Even as households paid down other types of debt after the bubble burst in 2007-2008, student loan balances continued to climb.¹⁴ With wages and job market prospects lower for young people than any other age group, the growing cost (and greater share of that cost being covered by individuals) is putting additional pressure on the lives of young Americans.¹⁵

Growth in Consumer Credit Since Debt Peak



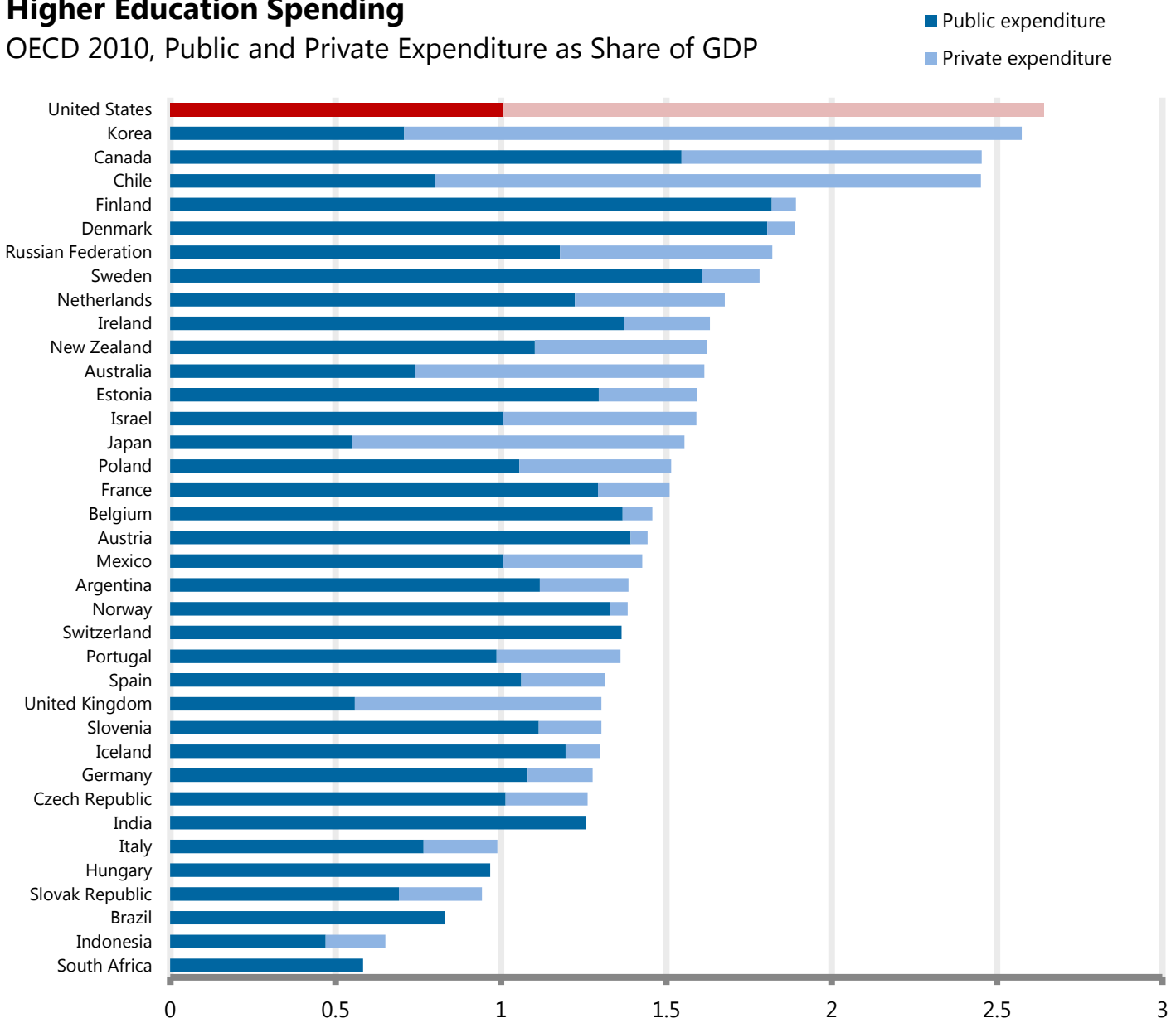
Source: Author analysis of data from Federal Reserve Board of New York

As with health care, the bulk of US higher education spending is private – despite the fact that the public sector educates the vast majority of students. (Public colleges and universities serve 72 percent of students).¹⁶ The US spent 1% of its GDP on public higher education in 2012, nearly identical to the average among similar countries. The US also spent 1.64% of GDP on private higher education, the third highest among countries reporting data. Only Korea and Chile spent more private money on higher education than the United States, but both countries had lower public spending on higher education.

College attendance in the US, however, is not the highest, especially not among young adults. The US ranks 12th in college completion for adults ages 25-34, just above average. In a large report on skills released last year, the OECD found

Higher Education Spending

OECD 2010, Public and Private Expenditure as Share of GDP



Source: OECD, Education at a Glance

that the US, despite its high levels of spending, ranked only average in literacy proficiency among young adults with a college education.¹⁷ While the US does have some of the best universities in the world at the most elite level, it also has very high educational inequality.¹⁸

Notwithstanding high performance by schools at the very top, it is not at all clear that the overall cost – combining the high price paid by the public sector, as well as the high and rising cost of tuition – is creating a better product for most students. The so-called college “arms” race, in which schools from bottom to top engage in a competitive spiral of increased spending, has become baked into the system with very few mechanisms for limiting the rising cost of higher education.¹⁹ At some schools, incentives have pushed expenditures away from educational purposes and toward “amenities,”²⁰ resulting in higher prices for students and the need for additional public financial aid. Yet the increase in cost and expansion of financial aid programs comes with very few guarantees or metrics to ensure that schools are working to provide a better education. Many expensive schools in lower tiers of the higher education system do not even meet baseline levels of quality, leaving both students and the public to foot a steep bill without much to show for it.²¹

RETIREMENT

The American retirement system consists of three major parts: a public social insurance program, Social Security; employer-based private pension programs, both defined-benefit and defined-contribution; and individual savings and assets.

As employers have tried to shift liabilities to employees off of their own books, they have switched from defined-benefit pensions to defined-contribution pensions. This shift has put the primary risk and responsibility for retirement funds on individual workers. Although defined-benefit pension benefits are costly for companies to provide, they are safer for retirees and are more equally distributed across workers of different income levels.²²

From 1979 to 2011, the total share of workers with access to retirement plans remained flat; what changed was the shift from defined benefit plans to defined contribution plans. Only 14% of all private sector workers have access to any kind of defined benefit pension, down from 38% in 1979.²³ Companies that do have defined benefit programs have tried to “de-risk” their pension liabilities in other ways: for example, companies can buy out employee plans for a lump sum cash payment or shift their retirement obligations onto a third-party insurance company whose assets are not backstopped by the Pension Benefit Guaranty Corporation.²⁴ While it was once a last-resort option, a handful of major employers – including Verizon, GM, and Ford – have pursued large-scale de-risking strategies in recent years.

One reason that both public and private pension and savings programs are so expensive is the role of intermediate management in investing the funds. An individual investor has to pay a series of fees, often hidden, to invest his or her retirement money, and the fees are much higher in actively managed plans regardless of how well the plan does. For agglomerations of savings, such as pension plans, private management fees also take a big chunk out of potential

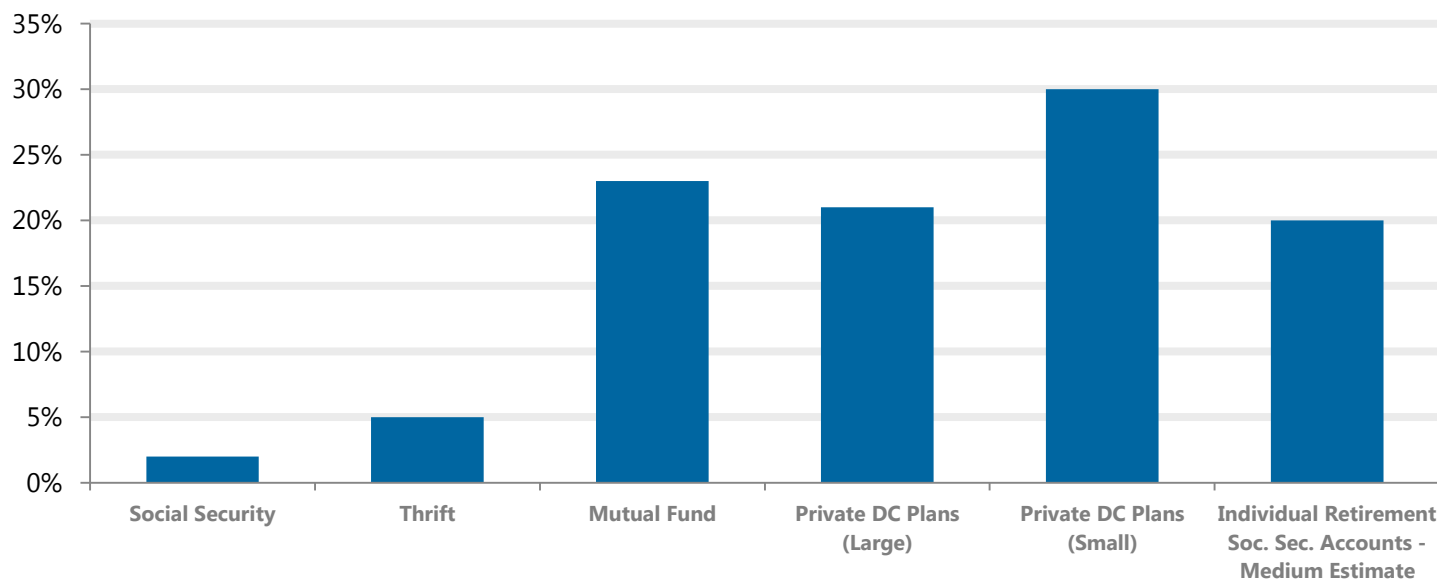
earnings. In this case, there is an additional cost of implicit government subsidy as well – if things go poorly, the government will have to bail out individuals who have lost money in the stock market.

These additional fees add up, but do not necessarily produce better results. New York City spent \$472.5 million last year to actively manage its pension fund – only to achieve lower returns than some internally managed public pension funds in other cities.²⁵ Ontario’s teachers’ public pension fund, for example, earned returns 1.6 percentage points higher than New York’s despite being internally managed. For individual investors, Demos analyst Robert Hiltonsmith estimates that fees and charges can add up to a third of an individual’s investment returns at the median.²⁶ A middle-income family could pay nearly \$155,000 over a lifetime, according to his data.

A 2004 study by the Congressional Budget Office compared the various costs incurred by an average worker over a lifetime under different retirement plans. Administrative expenses for the public system, Social Security (OASI), amounted to 2% of assets at retirement. The same calculation for mutual funds added up to 23% of an individual’s assets at retirement, and between 19% and 30% for private defined-contribution plans.²⁷

Administrative Costs of Retirement Plans

Estimated Percent of Assets Spent in Fees at Retirement



Source: Congressional Budget Office. Private Large and Small are Pension Dynamics Corporation Estimates; Individual Retirement Soc. Sec. Accounts -- Medium Estimate is from Goolsbee (2004).

BASIC FINANCIAL SERVICES

Beyond the standard elements of the social contract – health, education, and retirement -- another key component of economic security is the ability to safely store money and access small-scale credit services. In America, however, the cost of basic financial services is often extremely high. Many banks do not deal with small accounts, leaving tens of millions without banking services. Around 17 million adult Americans are currently “unbanked,” without a formal bank account,

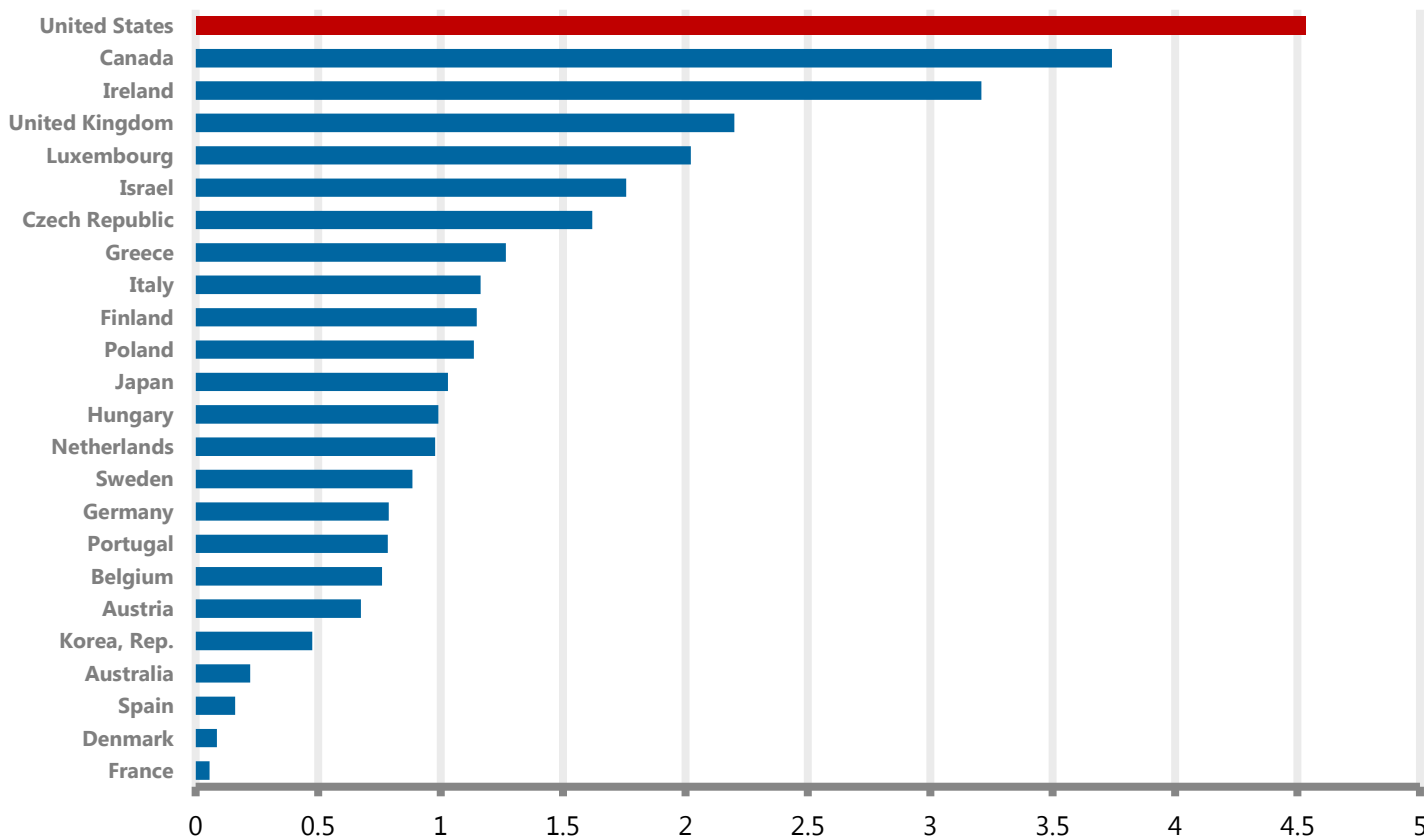
and an additional 51 million adult Americans are “underbanked,” going outside of mainstream banking services for at least some of their financial needs. More than half of African-American and Hispanic households are either unbanked or underbanked.²⁸

These individuals turn to alternative financial services like check cashers and payday lenders, which offer high-interest, short-term loans that are often expected to be repaid with a borrower’s next paycheck. Payday lenders charge fees that correlate to an annualized interest rate of about 400 percent, according to the Consumer Financial Protection Bureau.²⁹ In 2012, Americans spent \$89 billion in fees and interest for alternative banking services.³⁰ The people utilizing these services are often low-income or under financial distress – meaning that they are the least able to pay these high fees and interest costs.

One numerical indication of the cost of basic financial services is the rise in payday lending locations. The number of payday lending stores has grown rapidly: in 2001, there were about 10,000 stores nationally.³¹ A decade later, the number was upwards of 23,000.³² The US again stands out compared to peer countries: only six OECD countries have a smaller share of the poorest population (bottom 40%) with formal bank accounts, and the US has the highest share of the poor who have taken loans from an informal private lender in the past year.³³

Loan from an Informal Private Lender (Past Year)

Bottom 40% of Population by Income (as Share of Total Population > age 15)



Source: World Bank Financial Inclusion Index (FINDEX)

While many policymakers have proposed to rein in payday lending and other alternative financial services, they face a big hurdle: in many cases, these alternative financial services are a *better* option for low-income workers than the existing banking system.³⁴ Large banks often charge high fees, so individuals with volatile incomes – such as those with limited savings and unsteady wages – can actually face higher costs at traditional banks than by using very costly alternative banking services. The US does not have a basic public banking infrastructure to serve as a place for safe, low-return savings accounts.

One way policymakers have tried to expand access to financial services has been to encourage, force, or subsidize private banks to incorporate low-income people as customers. The most notable example of this is through the Community Reinvestment Act, or CRA, which eliminated “redlining” poor neighborhoods out of banking services over three decades ago. While the CRA has been generally credited with encouraging more access to mortgage funds for borrowers in low-income communities in the past, it also comes with risks – and it is unclear how useful it will be in the future.

The CRA only applies to depository institutions, yet an increasing share of financial assets is held by non-depository financial institutions like financial holding companies.³⁵ The CRA could also decrease credit access in the long term, as large banks pull back on their commitments after their CRA agreements end.³⁶ As Eugene Ludwig, James Kamihachi, and Laura Toh wrote as part of a Federal Reserve forum on the CRA, “Absent a CRA mandate that all financial services companies meet the needs of low- and moderate-income neighborhoods in the areas they serve, and an expansion of the CRA mandate to non-credit-related services, these lower-income areas will continue to be underserved in financial services and fall prey to unscrupulous practices.” It is difficult to imagine the CRA alone being sufficient to fill the need for safer, more stable banking options, particularly among lower-income Americans.

HIGH SPEED INTERNET SERVICES

As technology improves, the role of the Internet becomes more important both as a direct form of interpersonal connection as well as a type of infrastructure for other programs and services. Although access to the Internet lies outside of the traditional definition of the social contract, being connected is increasingly an essential good for economic security and opportunity. And many of the social programs mentioned herein rely on users to have Internet access, such as signing up for a healthcare plan, accessing bank accounts online, or transferring money to retirement funds. High-speed internet access – once a luxury – is quickly becoming central to employment, civil society, citizenship, and the functioning of the social contract.

The high cost of Internet services has characteristics of the “pay more, get less” model. At basic levels of Internet service, people in the US pay some of the highest prices in the world. A fixed basket of broadband Internet services at speeds of 2.5 Megabits per second, which is enough for an individual to perform most online functions (such as checking email and viewing videos) is more expensive in the US than in all but three countries in the OECD.³⁷ This basket costs \$44 per month in the US, compared to an OECD average of \$31 and an EU-19 average of \$29. At the highest Internet speeds, the US pays

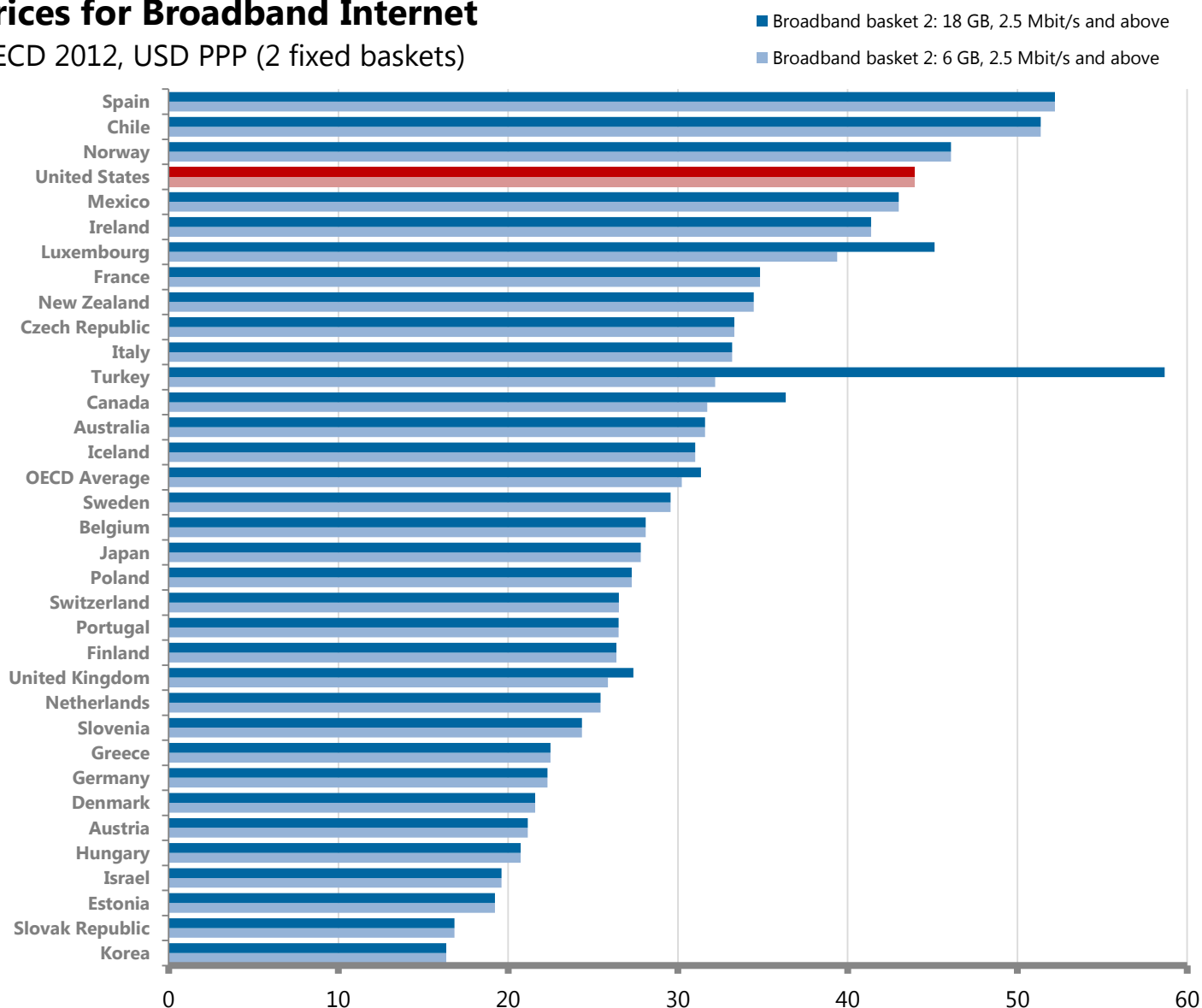
more than three times that of most of our peers and twice the OECD average. If three less-industrialized nations (Mexico, Chile, and Turkey) are excluded, very fast Internet in the US is the most expensive in the OECD.

Overall, despite this high price, the US gets only average results. Calculated in terms of price per megabit/second speed – or how much we are paying for how much value – the US ranks below average. The US pays between \$0.53 and \$41.70 per Mbit/s, while the OECD average is between \$0.51 and \$26.13 per Mbit/s and the EU-19 average range is \$0.46 and \$21.86 per Mbit/s.³⁸

Nor is broadband service keeping up with the benefits of technological improvements or the pace of improved services in other places. The price of cable broadband services in the US from 2010 to 2012 increased 12% while speed did not improve. Across the OECD, over the same time period prices only increased 2%, while speeds went up by 27%.³⁹

Prices for Broadband Internet

OECD 2012, USD PPP (2 fixed baskets)



Source: OECD Communications Outlook 2013

The US does face some challenges that make provision of Internet services more costly than in peer countries. Most notably, the US is a geographically large and diverse country that requires more expansive infrastructure. But it is not clear that size of the country is the main factor contributing to higher prices and slower speeds. If it were, we would see higher prices coming from greater levels of capital expenditure along with low profits, as the extra costs to consumers would be passed on to building a better network.

In recent years, however, capital expenditures as a share of revenues from major broadband providers have declined or remained flat.⁴⁰ Telecom companies have expanded investment on some of their wireless networks but pulled back from building out or improving wired infrastructure.⁴¹ Many broadband providers also have high levels of cash flow above and beyond capital expenditure.⁴² The simultaneous growth in prices above speed and capital expenditures suggests that it is not just a case of geographic challenges, but rather more of a function of policy and regulatory issues. As we look to the future, we appear to be facing an Internet system increasingly defined by paying more and getting less.

Understanding the Rise of Pay More, Get Less – And Searching For Solutions

One reason for the system of “pay more, get less” is the existence of an ongoing contradiction. In the United States, the notion of a more supportive, “European-style” welfare state is popular, particularly when viewed program by program. Programs like Social Security and Medicare attract support from a wide swath of the population, and Americans overwhelmingly prefer to raise taxes or increase progressivity of benefits rather than make cuts to the existing welfare state.⁴³

Yet at the same time, US policymakers also have an aversion to spending money directly and claiming that public programs can be successful. To try to bridge the gap between these competing forces, we have built a supportive welfare state while disguising its true size and costs.

As Steven Teles argued in an essay for New America’s Next Social Contract Initiative in 2012, much of American public policy can be described as a “kludgeocracy” – a series of kludges, or patches, which add complexity, confusion, and inefficiency to the system to avoid having to upend what already exists.⁴⁴ This often takes the form of a complex network of subsidies and tax code provisions that is vulnerable to rent-seeking among private providers in the system.

The examples of health care, higher education, and retirement security clearly fit this paradigm. In these sectors, U.S. public expenditure is not abnormal among peer countries; private expenditure, however, is much larger than anywhere else. The public social and economic supports in most peer countries are simpler and more universal, qualities which keep down costs and ensure access. In the United States, these programs are partially publicly subsidized but privately managed or contracted out. At times, the public provides subsidies for individuals or employers to purchase services from private sector providers.

In some parts of the economy, private provision can be more efficient or offer more choice to individuals. But when the system is increasingly complex, the private sector can extract economic rents through fees, middleman activities, or unregulated monopoly power. For basic goods and services which the government has to play a role in helping provide, private provision can make the system more, not less, expensive.⁴⁵ Higher education's mélange of financial aid programs is well-intentioned, for example, but the lack of better accountability contributes to rising costs and perverse incentives for schools to spend widely and decrease access.⁴⁶ The option to allow an individual to invest retirement savings appears to increase an individual's options, but for the vast majority who have little time, savings, or experience it is more likely a subsidy to the financial services industry for increased risk and unclear returns.

The same changes that have contributed to stagnant wage growth, including the rise of more contingent employment opportunities and shorter job tenure, have made it more difficult to build a solid social contract through employers in the private sector. Companies have tried to offload many of the costs of directly employing workers through outsourcing, subcontracting, and greater emphasis on the supply chain.⁴⁷ As companies seek to decrease their responsibility for providing benefits or higher wages, new policies continue to expect that they will be the primary source of these benefits. Policies thus require additional rules and incentives to override prevailing economic trends and business decisions, adding to the complexity and unsustainability of the system.

Across these sectors and others, the lack of clear and more direct regulation also contributes to higher costs and lesser results. In health care, nearly every country keeps prices low through a system of all-payer regulation, in which the government or another collective entity sets uniform prices for medical services. The US, however, often pays different prices for the same services, which has resulted in inflated prices, perverse incentives, and added administrative burdens.⁴⁸

In higher education, schools benefit from publicly subsidized financial aid programs, yet the government has few mechanisms for holding these institutions accountable for keeping costs reasonable. And one factor contributing to high prices for Internet usage in the US is a regulatory jumble: the FCC does not classify internet providers as telecom companies, which can be more heavily regulated as natural monopolies under Title II of the Telecommunications Act. Instead, internet providers are considered "information service" providers and therefore subject to less regulation of their prices despite a dominant presence in many markets.⁴⁹

The lack of adequate regulation is partially a function of the way the system is designed in the first place. Complex, privately run programs are very difficult to regulate and, as Teles and others have argued, have created entrenched interest groups pushing to fend off any new efforts to rein in the system.

The reluctance to fund and administer public programs has also created gaps in which private providers have failed to safely and affordably serve a subset of the population. Safe, low-cost, and universal public programs could complement existing industries, simultaneously increasing access and putting pressure on private providers to bring down costs elsewhere in the system.

Public community banks, for example, could fill some of the holes in the current financial system for individuals. Postal savings banks, which existed in the United States in the early and mid-20th century, could serve as a safe and inexpensive savings source for individuals with infrastructure that already exists.⁵⁰

For retirement savings, the public Social Security program has been the safest and most effective retirement savings option for most people. An expansion of that program, along the lines we proposed a year ago, would be the lowest cost and most universal option for a stronger retirement security program.⁵¹

Similarly to postal savings banks, the creation of public, low-risk, guaranteed public retirement savings programs to supplement the expansion of Social Security would also help individuals who want to build a safe nest egg rather than pay management fees and take on risk in the stock market. Numerous policymakers and scholars have proposed variations of this idea, but proposals differ on whether returns are guaranteed and who invests the money.⁵² The key is to ensure that it is a publicly managed program with guaranteed returns: this combination is the only way to pay less in fees and risk and get more in terms of retirement security.

Conclusion

The pattern of “pay more, get less” is not an isolated problem. Instead, it has come to define some of the most important areas of American policy. Our system of economic and social supports costs too much and provides too little, the result of a complex system of public subsidies, private rent-seeking opportunities, and inadequate regulation. In many cases, these programs and others that complement them cost the most for the very people who can afford them least.

Given the condition of American politics and the pervasive nature of this problem, there are many barriers that stand in the way of necessary reform. But making the effort to do so is increasingly important as the economic prospects for the working and middle classes continue to stagnate and the social contract falls further behind. At the same time, the extra expenses add fuel to the claim that we are spending too much money and diminish the prospects for more supportive programs – even though the results of current programs have fallen short.

Universal access to affordable health care, higher education, and retirement programs, as well as basic financial services and high-speed Internet, are necessary for a decent quality of life in an affluent, advanced nation like the United States – all the more so in an economic environment in which it is difficult to raise wages. And although there are political barriers, recalibrating our social contract is clearly within the realm of possibility – nearly every other peer nation outperforms the US and gets more services for less money. Widespread access at an affordable price is achievable with the right set of policies that move away from complex programs vulnerable to rent-seeking and toward simpler, universal, and better-regulated options.

Right now, the social contract is defined by “pay more, get less.” The future needs to flip the maxim around: pay less, get more, and raise the standard of living for the vast majority of Americans.

Notes

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- ⁹ The most recent data from the Census Bureau is for 2012 (see cite 1) and calculates an insurance coverage rate of 85%. If we estimate that up to 10 million new enrollees received insurance coverage that previously had none ([see here for estimate](#)), the total coverage rate is 88% using the same population figures. When new Census data is released next year it will not answer this question either, as the methodology for the survey has been changed.
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