

**The Economic Impact of the Health Care Sector within the  
South Central Kentucky Rural Healthcare Network:  
The Economic Impact on Clinton, Cumberland, Monroe & Wayne Counties**

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**August, 2004**

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## Table of Contents

Executive Summary .....	3
Preface .....	6
Introduction .....	7
Health Care as an Engine of Growth.....	7
The Role of Health Care in Economic Development .....	8
Financial Linkages .....	8
Non-financial Linkages .....	10
The Regional Economy .....	11
Economic Impact Analysis .....	14
Inflows and Outflows: Local and Non-local Purchases .....	14
Economic Impact Multipliers .....	15
Economic Impact Results .....	17
Summary .....	20
Appendix .....	21
Literature Review .....	21
Methodology .....	23
References .....	26

## EXECUTIVE SUMMARY

Health care represents an important part of rural economies. In an era when rural economies are struggling to keep pace with their urban counterparts, the health care sector (which includes hospitals, nursing homes, medical personnel and other resources) represents a bright spot in the economic landscape. The health care sector plays four major roles in rural economic development. First, a local health care system keeps health care dollars within a local economy. Second, it attracts external dollars into a community from outside a local area. Third, a local health care system can retain existing businesses as well as attract new industries into a community. Finally, a local health care system can support and promote a healthy and productive workforce within a community.

The South Central Kentucky Rural Healthcare Network is an important component of the regional economy of Clinton, Cumberland, Monroe and Wayne Counties. Since the South Central Kentucky Rural Healthcare Network consists of the county hospitals (that is, the network members are the local hospitals), the network itself creates the majority of the economic impact on this four county region. The health care system expenditures, as well as, the health care employees' expenditures exert a significant economic impact, and are highlighted in this report by illustrating the linkages the health care sector shares with other local industries. **Table 1** summarizes the impact of the health care sector on regional economy of Clinton, Cumberland, Monroe and Wayne Counties in South Central Kentucky during 2000.

**Table 1: Economic Impact of the Health Care Sector  
On the South Central Kentucky Rural Healthcare Network Area:  
Clinton, Cumberland, Monroe, and Wayne Counties**

<b>Multiplier Type</b>	<b>Direct Impact</b>	<b>Indirect Impact</b>	<b>Induced Impact</b>	<b>Multiplier</b>	<b>Total Impact</b>
<b>Output (Sales)</b>	\$102,485,088	\$9,859,724	\$22,149,158	1.31	\$134,493,973
<b>Labor Income</b>	\$52,593,224	\$4,591,218	\$7,642,772	1.29	\$64,827,217
<b>Employment</b>	2,029 Jobs	201 Jobs	402.4 Jobs	1.23	2,632.4 Jobs

*Source: changes that reflect the use of Implan: 2000*

The \$102,485,088 dollars represents the direct sales from the regional health care system to suppliers. The indirect impact of \$9,859,724 represents the health care vendors' spending within the region, and the \$22,149,158 signifies the employees' purchases of local goods and services. The employment multiplier shows that the health care sector indirectly created 201 jobs and health care employee spending creates 402.4 jobs, and that for one every health care job an additional 0.23 jobs are created in the regional economy. The labor income multiplier indicates the level of regional income that is dependent on the health care systems' payroll (see **Table 1**). The regional healthcare sector payroll generated approximately \$52,593,224 in direct labor income, and \$4,591,218 and \$7,642,772 through indirect and induced impacts, respectfully. The income multiplier illustrates that for every one dollar of labor income generated in the South Central Kentucky Rural Healthcare Network area, an additional 0.29 cents of income is generated in the regional economy. Overall, the results indicate that in 2000, the economic activities generated by the health care system in South Central Kentucky Rural Healthcare Network region created a total of 2,632.4 local jobs, \$134,493,973 in local revenues and \$64,827,217 in labor income.

This report may be useful when focusing on rural economic development in the South Central Kentucky region. Community leaders and economic development officials should identify the current economic and financial roles of the South Central Kentucky Rural Healthcare Network and other local health care providers. Second, opportunities for new medical services through network development should be identified and examined for potential growth in the South Central Kentucky region. New opportunities for local health care services will increase the economic impact on South Central Kentucky regional economy and should be examined to enhance the economic role of the local health care system. Further research or market demand analysis can determine the feasibility of providing services locally or regionally.

## **PREFACE**

This report is being furnished to local government officials, policy makers, health care providers and local citizens of South Central Kentucky. The Kentucky Rural Health Works Program (a program of the University of Kentucky Department of Agricultural Economics, University of Kentucky Cooperative Extension Service, Kentucky State Office of Rural Health and University of Kentucky Center for Rural Health) conducted this economic impact study for the South Central Kentucky Rural Healthcare Network. The Kentucky Rural Health Works Program offers decision-making information to rural health care providers, local community leaders and policymakers regarding health care and its impact on rural economies. This is carried out through market demand studies, feasibility studies, policy research studies and economic impact studies. The Kentucky Rural Health Works Program combines the health care knowledge and strengths of the University of Kentucky Center for Rural Health with economic development expertise of the University of Kentucky College of Agriculture.

Questions or concerns regarding this analysis should be directed to Dr. Eric Scorsone, Assistant Professor of Agricultural Economics at the University Of Kentucky College Of Agriculture. See the Kentucky Rural Health Works website at [www.ca.uky.edu/krhw](http://www.ca.uky.edu/krhw)

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## **INTRODUCTION**

### *Health Care as an Engine of Growth*

Over the last two decades, health care services have become a critical engine of growth in rural Kentucky. In 1980, health care industry earnings represented 6.7 percent of all industry earnings. By the late 1990's, health care's share of industry earnings had risen to 12.3 percent in rural Kentucky. These statistics indicate that health care is the second largest industry category in rural Kentucky trailing only local government. Furthermore, medical transfer payments, such as Medicare and Medicaid, now represent more than 9 percent of rural Kentucky's personal income. In contrast, in 1980 these payments only represented 2.9 percent of personal income.

Health care services include a wide range of resources, from facilities such as nursing homes to personnel such as physicians. Why are health care services growing so quickly? The health care industry is in part responding to the growing levels of retirement and medical transfer payments from Social Security and Medicare in rural Kentucky.

Very few rural communities have realized the full potential of local health care as an economic and community development tool. Rural communities have an extraordinary opportunity to improve their local economies and develop health care as a local business. The "warms you twice" adage of wood chopping also can be applied to health care. Every health care service provided locally benefits the rural community twice. First, it improves people's health and second, it improves the health of the regional economy.

This report documents the economic impact of the South Central Kentucky Rural Healthcare Network. This impact is measured by the number of jobs and labor income directly and indirectly associated with the local health care system. This study is divided into five major sections. The first section describes the role of health care in rural economic development. The second section examines the current status of the regional economy and the relative place of the health care industry. The third section demonstrates the direct and indirect economic

impact of the health care system on the regional economy. The fourth section provides a summary of the economic impact on the South Central Kentucky region due to the Network and other local providers. Finally, the appendix explains the methodology used in this report and provides a review of the literature on the economic role of rural health care.

## **THE ROLE OF RURAL HEALTH CARE IN ECONOMIC DEVELOPMENT**

The role of health care in economic development is based on financial and non-financial linkages with the rest of the regional economy. Financial linkages are based on the link between the health care providers' expenditures and revenues and other local firms' expenditures and revenues. The health care sector and other industries often mutually support one another through purchases and sales. These financial linkages create a larger regional economy.

Non-financial linkages are based on the health care sector's role in retaining local physicians, promoting a more productive workforce, and attracting new businesses and retaining existing ones. Although these may be measured through financial outcomes, generally the link is more indirect. Nevertheless, a strong health care system can promote economic development in a variety of non-financial ways.

### *Financial Linkages*

#### *Health Care: Keeping Local Dollars At Home*

The most important financial role for the local health care system is to "keep local health care dollars at home". There are many sources of local health care dollars including private insurance, consumer out-of-pocket payments, and Medicare and Medicaid transfer payments. If these expenditures leave the community, they represent a real loss of potential jobs and income

to local residents. Out-shopping, that is, payment for services that are outside of the regional area, remains an important issue for many rural health care providers and rural communities.

However, it is not only health care jobs that are at stake. Health care employers and employees are important purchasers of goods and services, which in turn support many local business establishments. Health care networks and providers represent an important source of income for other members of the community who may work in housing construction, retail establishments, restaurants and other local services. Hospitals and other health care facilities are also important purchasers of local inputs, that is, goods and services, such as laundry and waste management services. Increased employment in health care and other areas depends upon capturing the private and public sources of local medical expenditures.

#### *Health Care as a Basic (Exporting) Industry*

If health care providers can attract patients from outside their community, the health care industry can act as an export industry. In essence, the local health care industry exports its reputation and services, while attracting outside patients and outside dollars into the local community. This “exporting” may be based on, for example, a state-of-the art facility or a physician’s reputation. Regardless, “export” or external dollars from these outside patients represent an inflow of new dollars into the community’s economy. These export dollars then allow a community to purchase a wider variety of goods and services from other communities. The spending linkages created by these export or external dollars in turn generate new jobs and sources of income in the community.

#### *Health Care: Closing the Supply-Demand Gaps*

Identification of a community’s supply-demand gap will assist a community in “keeping health care dollars at home”. A supply-demand gap occurs when a regional economy does not supply (provide) the goods or services demanded (needed or wanted) by an individual or a

community. Consequently, residents are then forced to out-shop and make purchases outside their own community. The non-local purchases represent leakages (a loss) from the regional economy and reduce the potential employment and income opportunities in a community. In some cases, a community cannot provide these goods or services because of market or financial limitations. However, there may be circumstances that allows local businesses to provide the demanded goods or services locally, which would close the supply-demand gap and keep local dollars at home. A community should examine the supply-demand gaps within their local community to determine if opportunities are being missed. This may be especially true when key demographic or economic changes occur. These changes can generate new opportunities that did not exist in the community previously.

### *Non-Financial Linkages*

#### *Health Care: Attracting and Recruiting Industry*

An important aspect of the health care system in economic development is its ability to attract and recruit firms based on community services. Company surveys reveal that managers often look at health care as an important issue in locating facilities. The existence of a strong health care network can lower health care costs for firms and their employees, and provide value-Networked services for firms such as occupational health. In addition, retirees and workers are more likely to choose a location that has access to quality health care services.

#### *Health Care: Promoting a Healthy and Productive Workforce*

In today's economy, a productive workforce is critical to businesses, and is vital in the recruitment of new firms and retention of existing firms. The health status of local workers can be an important ingredient in productivity. Local health care providers can improve the health and productivity of the local workforce by promoting preventive care, thus leading to long-term

economic benefits. On the contrary, if a community's workforce is substantially less healthy than other communities, this may be considered a cost burden by some industries.

The combination of changing demographics, growth in health care service employment and the increase in medical transfer payments implies that the health care system will be a major player in future economic development for rural Kentucky. This fact was recognized in the Kentucky Appalachian Commission's strategic plan, "State Goal 5.2: Kentucky will recognize health care as a substantial economic sector and pursue strategies to grow the sector" (Kentucky Appalachian Commission, 2000). Economic development agencies, businesses groups and local governments should play a more active role in promoting the health care sector as a key partner and primary sector in generating new economic opportunities.

## **THE SOUTH CENTRAL KENTUCKY RURAL HEALTHCARE NETWORK REGIONAL ECONOMY: CLINTON, CUMBERLAND, MONROE AND WAYNE COUNTIES**

An examination of the sources of personal income in the community can lead to a better understanding of the potential sources of revenue for local health care providers. **Table 2** indicates that 53.4 percent of the total personal income for the South Central Kentucky Rural Healthcare Network area was from total earnings. Total earnings were adjusted to reflect earnings by place of residence. **Table 2** also shows that 32.6 percent of the total personal income was from transfer payments, such as Social Security, Medicare and Medicaid. Of the total personal income for the year 2000, retirement based transfer payments contributed 28.8 percent while medical payments contributed 48.4 percent.

**Table 2: Economic Data for the South Central Kentucky Rural Healthcare Network Region, Kentucky and the Nation (Thousands of Dollars)**

Source of Income, Earnings Transfer Payments	Network Total (\$)	Network Percent (%)	State Percent (%)	National Percent (%)
<b>Total Personal Income</b>	819,964	-----	-----	-----
Earnings by Place of Residence	437,528	53.4	65.2	69.0
Transfer Payments	266,943	32.6	17.1	13.0
<b>Total Earnings by place of work</b>	445,504	-----	-----	-----
Wages and Salaries	303,929	68.2	79.2	80.0
Proprietor's Income	74,202	16.7	10.7	12.0
Other Labor Income	67,373	15.1	10.1	9.0
<b>Transfer Payments</b>	266,943	-----	-----	-----
Retirement and Disability	76,807	28.8	41.0	40.0
Medical Payments	129,123	48.4	38.2	40.0
Other transfer payments	334	0.1	0.8	0.5

Source: Bureau of Economic Analysis (2000 Data)

**Table 3** indicates that the 2000 average per capita income for the South Central Kentucky Rural Healthcare Network region was \$17,105 as compared to \$24,085 for the State of Kentucky and \$29,469 for the nation. A disparity in per capita income between the region, state and the nation suggests that the local health sector may be smaller than expected given the population base of the region. However, growth in per capita income, particularly driven by Medicare and Medicaid, may potentially lead to higher medical expenditures in the community. Growth in industry and private earnings may also lead to greater medical expenditures depending on private insurance coverage.

**Table 3: Per Capita Income for The South Central Kentucky Rural Healthcare Network Region, Kentucky and the Nation**

Source	Network Total (\$)	State Total (\$)	National Total (\$)
Per Capita Income	\$17,105	\$24,085	\$29,469

Source: Bureau of Economic Analysis (2000 Data)

The South Central Kentucky Rural Healthcare Network regional economy is comprised of a diverse group of industries including manufacturing, construction, retail and wholesale trade, finance, transportation and services. **Table 4** indicates the industries that are present in the South Central Kentucky Rural Healthcare Network area and the personal income by industry for the region. The regional economy is largely dependent upon Manufacturing with \$140,385,000, the Government with \$91,456,000 and the Service industry with \$70,876,000. The Service sector is the third largest industry in the regional economy. The Health Care industry is comprised within and is part of the Service sector. Over the past decade, the Services industry has grown by 91.1 percent while the Health Care sector increased by 153.9 percent.

**Table 4: The South Central Kentucky Rural Healthcare Network Regional Economy  
Personal Income by Industry (Thousands of Dollars)**

<b>Industry Category</b>	<b>1990 Income (\$)</b>	<b>2000 Income (\$)</b>	<b>Percent Change (%)</b>
<b>Private Industry</b>	177,173	319,731	80.5
Agriculture	989	N/A	N/A
Mining	2,958	N/A	N/A
Construction	8,305	16,949	104.1
Manufacturing	83,126	140,385	68.9
Transportation	6,302	12,778	102.8
Wholesale	5,629	9,368	66.4
Retail	27,118	47,809	76.3
Finance	5,662	12,366	118.4
Services	37,084	70,876	91.1
<i>Health Care</i>	<i>15,906</i>	<i>40,385</i>	<i>153.9</i>
<b>Government</b>	50,072	91,456	82.6
<b>TOTAL</b>	<b>227,245</b>	<b>411,187</b>	<b>80.9</b>

*Source: Bureau of Economic Analysis (2000), N/A = Not Available*

**Table 5** shows the transfer payments by type for 1990 and 2000. Comparing **Table 4** to **Table 5**, it is evident that the growth in private industry was less than the growth in federal and state transfer payments to individuals. While private industry grew by 80.5 percent, total

transfer payments for the region increased by 99.0 percent. The increase in transfer payments is primarily driven by Social Security, Medicare and Medicaid payments. Of the total transfer payments, the medical payments, which include Medicare and Medicaid, increased by 158.0 percent. Once again from **Table 2**, transfer payments represent 32.6 percent of total personal income. The rapid growth of medical transfer payments signifies the potential for health care expansion and represents an important source of revenue for local health care providers and the community.

**Table 5: South Central Kentucky Rural Healthcare Network Regional  
Transfer Payments (thousands of Dollars)**

<b>Transfer Payment</b>	<b>1990 (\$)</b>	<b>2000 (\$)</b>	<b>Percent Change (%)</b>
Medical payments	50,073	129,123	158
Retirement benefits	43,028	76,807	79
Income (welfare) benefit	24,601	36,622	49
Unemployment insurance	3,801	6,419	69
<b>Total transfer payments</b>	<b>134,259</b>	<b>266,943</b>	<b>99</b>

*Source: Bureau of Economic Analysis (2000)*

## **ECONOMIC IMPACT ANALYSIS**

### *Inflows and Outflows: Local and Non-local Purchases*

A regional economy can be conceived of as a barrel with inflows and outflows of monies into and out of a community. The inflows represent external dollars coming into the community that expand the size and strength of the region's economy. Inflows of external dollars represent, for example, federal and state expenditures, money spent by tourists and other people from outside the community who spend within the regional economy. The outflows represent leakages (or a loss) out from the economy, which reduces job creation or local income. Outflows include state and federal taxes, non-local purchases of goods and services, people traveling to other sites for vacation and out-shopping for medical services in another

region. Local taxes do not represent an outflow; taxes are spent on creating local public goods such as roads, schools, and police and fire protection.

The economic impact of the health care sector on a local community is dependent on a number of factors. In general, the two major economic impact determinants are local purchases and non-local purchases. In effect, non-local purchases represent a leakage (a loss) from the regional economy. For health care providers, many purchases by necessity must be made from distant locations. The complex technology and equipment of modern medicine is subject to large economies of scale and is only produced in a few places in the nation. This equipment might include x-ray machines, MRI equipment and other surgical equipment. Pharmaceutical supplies and drugs are also subject to these same forces. In addition, some types of audit, legal and accounting services must be purchased from urban regions due to the complexity of services.

However, the local health care system purchases many goods and services from within the local area, which in turn, positively impacts the community. Therefore, health care employees and professionals are a major source of economic impact in the regional economy. These health care employees and professionals, turned consumers, spend large amounts of their income in local retail outlets, housing, automobiles and other services. These consumer (health care employees and professionals) expenditures support a large number of local resident service jobs such as mechanics, retail clerks, real estate agents and bankers.

### *Economic Impact Multipliers*

The impact of local health care system and health care employee expenditures are called multiplier effects. Multiplier effects are a simplified and compact way of representing these economic effects in a regional economy. The multiplier is interpreted as the impact of a one-unit change in sales, employment or labor income that results in an “X” impact on the regional economy. In essence, the multiplier represents the recycling of local dollars and

income in the community. This recycling process creates new job opportunities and higher wages for individuals. Leakage of dollars and income out of the community, via taxes or non-local spending, reduces the size of the multiplier effect and the potential size of the regional economy.

There are three multipliers effects based on the type of economic impact analysis: direct effect, indirect effect and induced effect (see **Table 6**). The direct multiplier effect is based on an industry's initial economic impact on the community. For example, if a manufacturing plant has revenue of 5 million dollars, then this figure becomes the direct economic impact on the community. The indirect multiplier effect is based on industry-to-industry transactions only. For example, health care providers may purchase laundry, food, landscaping and floral services from local businesses. It is important to note that the indirect multiplier does not include the effect of employee spending on retail and service sectors in the community. Alternatively, the induced multiplier effect includes both the industry-to-industry transactions and household purchases, which includes employee spending. The total economic impact is defined as the direct plus indirect plus induced economic effects.

The direct, indirect and induced multiplier effects can be classified as output (sales), employment and labor income multipliers (see **Table 6**). Output (sales) multipliers represent the change in local sales or revenue due to a change in an industry. Economic output is measured as a change in total sales for a new or existing business or institution in a region. Employment multipliers are the impact of a one million dollar change in economic output on the number of jobs in a regional economy. Labor income multipliers represent a one-unit change in economic output on local income.

**Table 6: Health Care Related Economic Impact Multipliers**

<b>Multiplier Type</b>	<b>Direct Impact</b>	<b>Indirect Impact</b>	<b>Induced Impact</b>
<b>Output (Sales)</b>	Health care revenue	Health care supplier revenue	Local retail and service revenue related to health care employee spending
<b>Employment</b>	Health care jobs	Health care supplier jobs	Local retail and service jobs related to health care employee spending
<b>Income</b>	Health care employee income	Health care supplier employee income	Local retail and service income related to health care employee spending

*Economic Impact Results*

The South Central Kentucky Rural Healthcare Network (the Network consists of Clinton, Cumberland, Monroe and Wayne County Hospitals) is an important component of the regional economy. This importance can be measured via the linkages the health care sector shares with other local industries. When there is an increase in health care revenue or in the number of health care employees within a community, these changes feed through the rest of the local economic system. For example, more supplies may be purchased through local vendors or new employees may purchase homes and spend money in local stores. The expenditures from the health care system, health care employees and health care professionals are important pieces of the economic puzzle.

The economic impact of the South Central Kentucky Rural Healthcare Network and other health care providers on the regional economy (Clinton, Cumberland, Monroe and Wayne Counties) is illustrated through three different multipliers, and presented in the following order: 1) output or sales multiplier 2) employment multiplier 3) labor income multiplier. The output (sales), employment and labor income impact analysis is summarized in **Tables 7, 8 and 9** below.

The output (sales) multiplier represents the amount of local sales or revenue generated in the regional economy due to the impact of the South Central Kentucky Rural Healthcare Network and other local health care providers (see **Table 7**). This revenue represents sales

from vendors to the health care providers. The \$102,485,088 dollars represents the direct sales from the health care system to suppliers and is the direct multiplier effect. Health care vendors are supplied by other vendors, thus creating more employment and income opportunities. Subsequently, the indirect impact of \$9,859,724 represents the health care vendors' spending within the South Central Kentucky Rural Healthcare Network region. Finally, the \$22,149,158 generated from the induced impact is associated with health care employees' purchases of goods and services locally. Based on the output (sales) multiplier, the regional health care sector had a total economic impact of \$134,493,973 as indicated in **Table 7** below.

**Table 7: Economic Impact on Regional Output (Sales)**

Direct Impact On Output (Sales)	Indirect Impact On Output (Sales)	Induced Impact On Output (Sales)	Output (Sales) Multiplier	Total Impact On Output (Sales)
\$ 102,485,088	\$ 9,859,724	\$ 22,149,158	1.31	\$ 134,493,973

*Source: changes that reflect the use of Implan: 2000*

The employment multiplier demonstrates the relationship between the health care system expenditures and employment creation in the local community. For the South Central Kentucky Rural Healthcare Network health care sector, the employment multiplier is 1.23 shown in **Table 8**. This employment multiplier shows that the health care sector directly creates 2,029 jobs, indirectly creates 201 jobs and health care employee spending creates 402.4 jobs. The employment multiplier indicates that for one every health care job an additional 0.23 jobs are created in the regional economy. In total, 2,632.4 jobs in the South Central Kentucky Rural Healthcare Network area are directly or indirectly tied to the local health care system finances.

**Table 8: Economic Impact on Regional Employment**

Direct Impact On Employment	Indirect Impact On Employment	Induced Impact On Employment	Employment Multiplier	Total Impact On Employment.
2,029 Jobs	201 Jobs	402.4 Jobs	1.23	2,632.4 Jobs

*Source: changes that reflect the use of Implan: 2000*

**Table 9** illustrates the impact of the health care sector on South Central Kentucky Rural Healthcare Network regional economy in Clinton, Cumberland, Monroe and Wayne Counties during 2000. The income multiplier indicates the level of regional income that is dependent on the regional health care system's payroll. The health care employee payroll generates approximately a total of \$52,593,224. This \$52,593,224 represents the direct impact on the regional economy. This income translates into more local spending, job creation, and consequently, more income in the community. The indirect impact from the labor income was estimated to be \$4,591,218. The induced impact was \$7,642,772 and the total labor income impact was \$64,827,217 for the region. The income multiplier was estimated to be 1.29; that is for every one dollar of labor income generated in the health care sector, an additional 0.29 cents of income was generated in the regional economy.

**Table 9: Economic Impact on Regional Labor Income**

Direct Impact On Labor Income	Indirect Impact On Labor Income	Induced Impact On Labor Income	Labor Income Multiplier	Total Impact On Labor Income.
\$ 52,593,224	\$ 4,591,218	\$ 7,642,772	1.29	\$ 64,827,217

*Source: changes that reflect the use of Implan: 2000*

## **SUMMARY**

In 2000 alone, the South Central Kentucky Rural Healthcare Network, along with other local health care providers, created \$134,493,973 in sales, 2,632.4 in jobs and \$64,827,217 in local income within Clinton, Cumberland, Monroe and Wayne Counties. Further, the local health care system within this four county region represents 12 percent of the private economic activity. This percentage compared favorably with other industries in the community. Health care has been called the “main economic engine” of the next decade. South Central Kentucky Rural Healthcare Network is in a position to capture many of the economic and financial benefits of this engine.

This report should be used to stimulate economic development and community planning discussions. Community leaders in Clinton, Cumberland, Monroe and Wayne Counties should identify the economic and financial role of the South Central Kentucky Rural Healthcare Network in local and regional economic development activities. Second, supply-demand gaps should be examined to find potential opportunities for new or expanded medical services within the region. Seeking out new opportunities for local and regional services will increase the economic impact of health care system on the regional economy. Health care network development and related activities should be examined to enhance the economic role of the local health care system and further simulate local and regional growth. Further research or market demand analysis can determine the feasibility of providing services locally or regionally

## **APPENDIX**

### *Literature Review*

A wide variety of health care services are available to community. These services may include, for example, hospitals, physicians, dentists, pharmacies, health clinics and nursing homes.

Each of these services contributes to the regional economy with hospitals generally supplying the largest portion of the impact. The literature on the economic impact of health care services on regional and local economies indicate that 1) health care services contribute as export industries for regions in which they are located, and 2) health care services reduce the region's imports by providing services to local residents, who would otherwise seek services outside the region or local area. Both effects of decreasing imports and increasing exports, stimulate and increase local and regional income. The direct impact of the health care sector to local and regional economies is measured through wages paid to employees, through inputs purchased by the health sectors and through the spending generated through the multiplier effect.

Among the recent studies is the impact of health care on a regional economy by Lichty et al. (1986) where a simulation model using input-output was used to assess the health care sector impact on Arrowhead (a seven county area) region in Northeast Minnesota. The model estimated the impact of removing an entire health care sector as well as the impact of closing one hospital. Obviously, the elimination of the entire health sector had a far more dramatic impact on the region, indicating a loss of 42 percent, from 121,305 to 70,004 of total employment over a period of six years in the baseline if the medical sector was removed. Also, regional gross output declined by 22 percent from \$ 4,962,141 000 to \$3,866,211,000. A more modest impact was that of a closing hospital with a loss of 1,200 employees and a decline in gross output of 2.1 percent (from \$4,962,141,100 to \$4,855,977,000) from the baseline, by 1990.

A similar study was done by McConner and Wellever (1989) that examined the impact of a hospital sector on a state economy. An input-output model was used to examine the impact

of a Montana hospital on employment, household income, and the level of goods and services produced in the state of Montana. The study revealed a significant hospital impact on total state revenues, salaries and wages and on total employment. Total revenues had a 1.60 multiplier from business spending totaling \$402,131,432 million in 1987. Similarly, salaries for professionals and employment had 1.61 and 1.30 multipliers that totaled indirect impacts of \$196,664,645 and 9,000 respectively.

In terms of a base industry, rural hospitals depend heavily on reimbursements from Medicare and Medicaid and the impact of these federal dollars into the rural communities is very significant. Lee et al. (1988) found that for each state dollar spent on Medicaid there is a federal match of \$3.69 in Mississippi. From the \$4.69 Medicaid expenditure, \$3.05 was spent on income in terms of wages and salaries. He also applied the state income multiplier of 2.172 to generate a total income impact of \$6.62 on the economy concluding that Medicaid dollars from outside the state economy had significant impact of the overall economy of Mississippi.

An earlier study by Moore (1974) measured the impact of the Upstate Medical Center on the community of Syracuse, New York, where he estimated an income multiplier of 2.63 indicated that each dollar of direct expenditure by the medical center produced \$2.63 of total expenditure. Moore concluded that large public institutions, such as hospitals have the potential to generate millions of dollars in employment and personal income through, in effect, interregional trade.

Extensive studies have indeed indicated the importance of health care to regional and local economies, especially hospitals. More recent studies have measure the impact of hospitals particularly in rural areas. McDermott et al. (1991) measured the impact of four small rural hospitals in Utah on their local economies. He found that these hospitals contributed between 4.0 to 9.0 percent of the average employment in their local, both directly and indirectly.

An earlier study by Christianson and Faulkner (1981) examined single-hospital rural counties from Montana, Nebraska, Nevada, Idaho, North Dakota, South Dakota, Wyoming and

Utah to measure the importance of a rural hospital to the community's income in each respective county. They found that income associated with hospital salaries generated, on average a 1.36 percent of direct benefit to the total county income, and had a multiplied income effect from hospital expenditures ranging from 1.54 to 2.37 percent of total county income. The loss from a hospital closer was less significant ranging from 1.53 to 2.29 percent of total county income.

A recent study by Doeksen and Altobelli (1990) also measured the change in local economic activity in three Texas communities of Crowell, Breckenridge and Graham if there was a hospital closure. They found that employment would decrease by 1.1 to 3.0 percent for the baseline for 1994. Similarly, income and retail sales would drop by almost a percent under the same circumstances. This, they concluded, would be detrimental to the regional economy.

### *Methodology*

The IMPLAN model was used to generate the economic impact of the South Central Kentucky Rural Healthcare Network health care. IMPLAN is an input-output model that can be used to examine the economic impact of new industries, loss of an existing industry, fiscal impact analysis and the existence of supply demand gaps. Model version 2.17 was used in this study with the 2000 Kentucky data and structural matrices.

An input-output model is a set of linear equations expressed in matrix form. The so-called Leontief inverse of this matrix reveals "multipliers". Multipliers express in compact form, the relationship between sectors of an economy. In essence, a change in an industry, household, or government expenditure pattern gets reflected through the study economy.

A number of important assumptions underlie input-output analysis. First, prices are fixed in the model. This implies that no relative price changes occur in the economy that would affect resource allocation. Typically, economies assume that a price change affects the relative

number of quantities or goods in an economy. Second, supply of factors, such as labor and capital, is always available at the same price. Again, whatever capital or labor is needed by the healthcare sector will be available to a rural community.

IMPLAN industries are based on a relationship called a production function. A production function specifies the dollar value of inputs used by an industry to create its output. The production function is specified as a series of coefficients, called gross absorption coefficients that reflect the percentage of total inputs coming from a particular industry. In essence, these coefficients reflect the recipe for an industry. Industry ingredients, capital and labor, are combined to create a certain dish or output. In this case, lab supplies, surgical equipment, nursing home beds, nurses and doctors and other factors are combined to create the output called health care.

IMPLAN production functions originally exist based on a national data set. Hospitals and other health care providers from across the nation, both urban and rural, are surveyed by the Census Bureau to determine their expenditure purchasing patterns. These national purchasing patterns are used by IMPLAN to create a regional version of a county's health care production function. However, often this national purchasing pattern is quite different from what actually occurs in a rural health care setting.

This production function is also modified to reflect local versus external purchases of inputs. The distribution of local versus external expenditures is called the regional purchase coefficient. The coefficient is a number between zero and one reflecting the percentage of goods and services bought locally. If an industry purchases an input from outside the community, this purchase is not reflected as an expenditure in other local industries. For example, if a health care provider purchases waste management services from a local provider that industry in turn expands and hires workers. If waste services are purchased outside the community, the expenditure is lost or leaked out of the regional economy. Again, these local versus external purchasing patterns are based on aggregate national conditions and may not

accurately reflect local purchasing patterns. It is critical to properly account for local production functions and local purchases by the health care sector.

For this study, it was felt important to capture the nature of the South Central Kentucky Rural Healthcare Network Health care purchasing patterns as opposed to the use of national standard production function. After the initial model for the South Central Kentucky Rural Healthcare Network was developed, the expenditure records for the health care were reviewed to determine health care spending patterns. Where available, other health care provider records were examined to determine expenditure patterns. These patterns were in some cases significantly different from the original IMPLAN health care expenditure patterns. Also, the regional purchase coefficients were significantly different in some cases between the original IMPLAN model and the revisions based on the South Central Kentucky Rural Healthcare Network records. The revisions of local spending correspond with findings from other studies that rural health care providers generally affect wholesale and retail trade activities regionally.

Once these revisions are made to the IMPLAN model, the impact of the health care sector is generated. Employment, output and value Networked multipliers are calculated for the hospital, nursing home, doctor's office and other health care provider sector in the community. These multipliers represent the South Central Kentucky Rural Healthcare Network health care sector indirect and induced economic impact on the community. Again, this impact is based on a positive change in the health care sector and its impact on other local economic sectors. The economic impact was calculated by removing the newly created health care sector through the Impact screen and determining the loss in employment, labor income and output.

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