# The Economist's Invisible Hand in the Patient Protection and Affordable Care Act

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# Introduction

- **Pre-2009, U.S. health care system had seen:**
  - Rapidly rising costs in both private and public sector
  - Increasing % of Americans without health insurance
- **Huge strain on families, employers, and governments**
- **Previous efforts at reform had failed**
  - Truman, Nixon, Clinton, and others
- **Major issue in 2008 Presidential election**
  - Democratic and Republican primaries
  - General election
- **Obama's victory with large majorities in House and Senate**
  - Was the time finally right for comprehensive reform?

## Signs in Late 2008 / Early 2009

- **Favorable for reform's prospects:**
  - Strong support for the President
  - Large majority of Democrats in both House and Senate
  - April 2006 Massachusetts health reform passage
  - Continued declines in health ins coverage and rapidly rising costs
  - Consensus on both sides of aisle on need to "do something"
- **A few obstacles to / challenges for reform:**
  - Rapidly rising unemployment, declining stock market, etc.
  - Clinton experience suggested long and treacherous slog
  - Tom Daschle withdrawing from HHS Secretary
  - "Only 58 senators" (Franken-Coleman race still unsettled, Specter)

# The Economics of Health Insurance

- **Substantial risks of very high medical expenses**
  - Most people are risk-averse and thus want to insure against this
  - Similar rationale as for life, home, auto, etc. insurance
- **One possible policy – give $X to person if they become ill**
  - $X increases with the severity of the illness
  - But very difficult to measure illness severity with one number
- **Thus most policies simply pay actual health care costs**
  - This lowers the price of health care treatments to the consumer
  - Demand curves slope down – they get more health care
  - Can be very inefficient if benefits of that care are low
  - Co-pays and deductibles to reduce inefficiency but it still exists

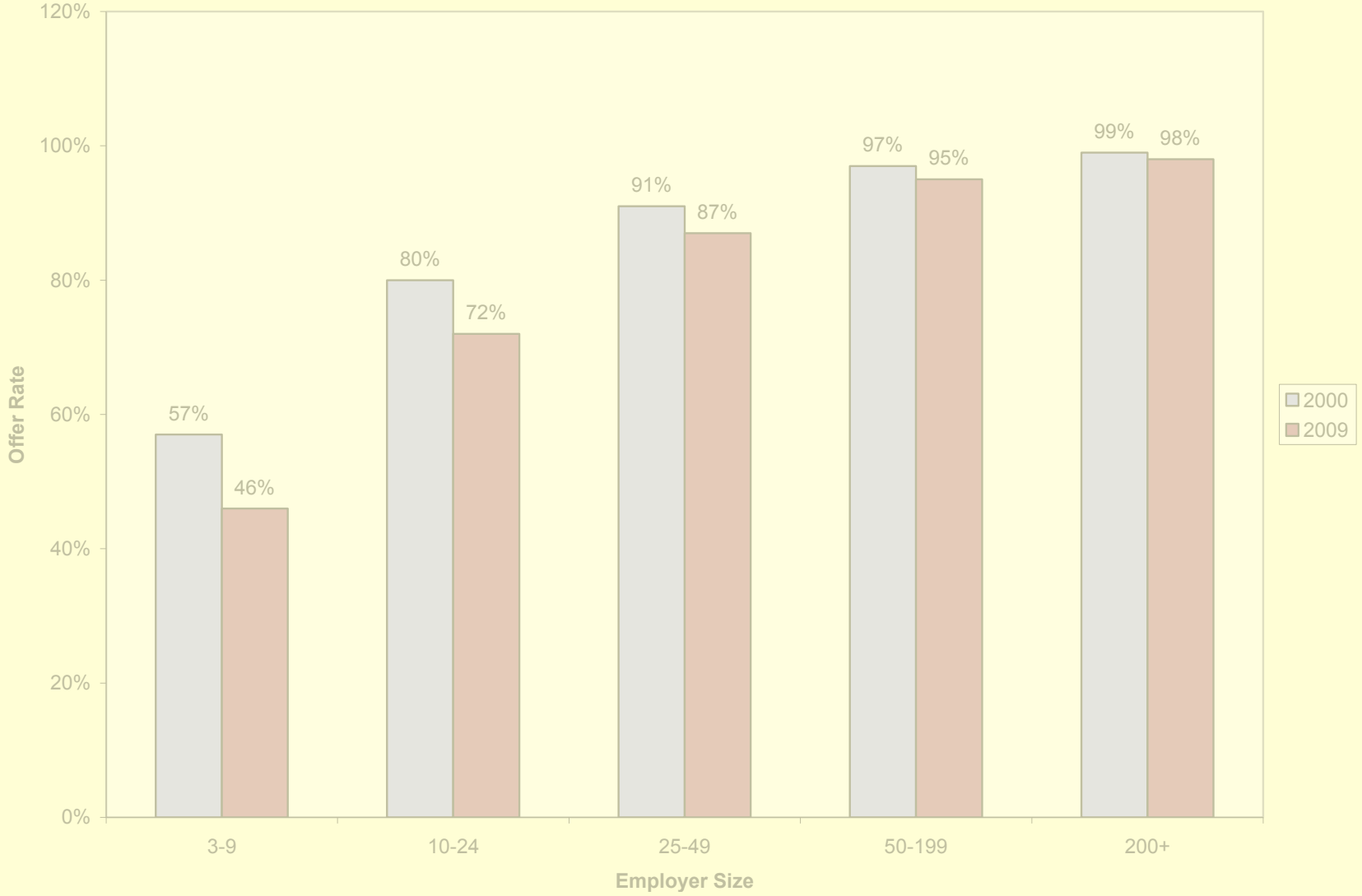
# The Economics of Health Insurance (continued)

- **No simple way around this inefficiency: "moral hazard"**
  - The over-consumption of health care resulting from distorted prices
  - And this problem is compounded by asymmetric info: health care providers know more and may benefit financially from more care
- **A related challenge in health insurance: "adverse selection"**
  - Those with low risk of high costs may decide not to buy insurance
  - Drives up premiums for those who do buy insurance
- **But the uninsured sometimes do need (expensive) health care**
  - Much of this ends up unpaid and imposes "hidden tax" on the insured
  - Provides rationale for a "mandate"
  - But health insurance is expensive so many uninsured need subsidies

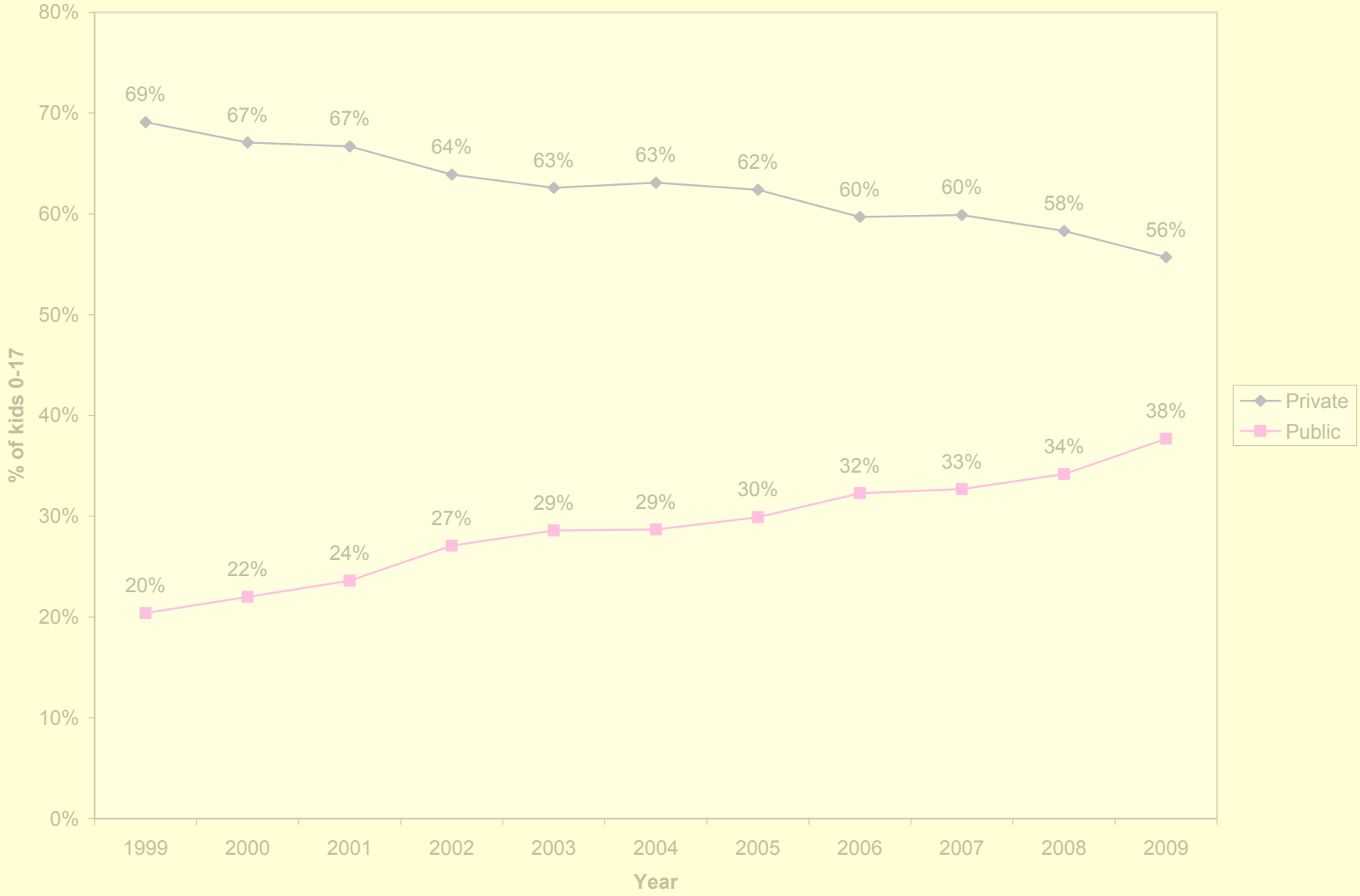
# Trends in Private Health Insurance: 1999-2009

- **Virtually all (> 90%) with private HI obtain through employer**
- **Average family ESI premium up 67 percent from 2000-09**
  - $8,019 in 2000 versus $13,375 in 2009
- **Similar increases in costs of single coverage**
- **Contributed to stagnant wage growth during period**
  - Median household income: $52.4k in 1999 versus $49.8k in 2009
- **Decline in employer offer rates and in private HI coverage**
  - Especially at smaller firms and their employees
  - Accelerated during economic downturn
  - Differential effect across states in U.S.
  - Among kids, more than offset by rise in public coverage

# ESI Offer Rates by Firm Size in 2000 and 2009



# Declining Private and Rising Public HI Coverage



# Substantial Differences across States in % Uninsured

| State | Ages 0-64 | Ages 18-64 | Ages 0-17 |
|---|---|---|---|
| Massachusetts | 4.1% | 5.2% | 1.0% |
| Wisconsin | 11.4% | 13.3% | 6.8% |
| New York | 11.5% | 14.3% | 3.8% |
| Pennsylvania | 12.4% | 14.2% | 7.8% |
| Ohio | 13.3% | 16.4% | 5.5% |
| Washington | 13.5% | 17.7% | 3.6% |
| New Jersey | 13.8% | 17.6% | 3.8% |
| Illinois | 14.2% | 18.8% | 2.5% |
| Michigan | 14.6% | 18.3% | 5.2% |
| Maryland | 15.3% | 18.6% | 6.1% |
| Tennessee | 16.3% | 19.5% | 7.4% |
| Virginia | 16.6% | 19.6% | 8.2% |
| Missouri | 16.8% | 20.8% | 7.7% |
| Arizona | 18.3% | 22.2% | 9.3% |
| North Carolina | 19.1% | 24.2% | 6.4% |
| Indiana | 19.7% | 22.1% | 14.0% |
| California | 20.4% | 25.2% | 8.9% |
| Georgia | 21.1% | 25.2% | 9.9% |
| Florida | 23.2% | 26.8% | 13.1% |
| Texas | 27.0% | 31.6% | 16.9% |
| All states | 17.5% | 21.1% | 8.2% |

# Pre-Reform Trends in Overall Health Care Costs

- **Health care at more than 17 percent of GDP in 2009**
  - Projected by CBO to increase to one-third of GDP by 2040
  - One-fourth due to demographics, rest due to excess cost growth
  - Dartmouth Atlas suggests up to one-third of spending is wasteful
- **Growing strain on government budgets**
  - Medicare + Medicaid was projected to grow from 6 percent to 15 percent of GDP from 2009 to 2040
  - Partly attributable to aging of baby boom generation
  - Medicaid now the largest component of state budgets
- **Effects on wages, employment, taxes, gov't services, deficit, and economic well-being**

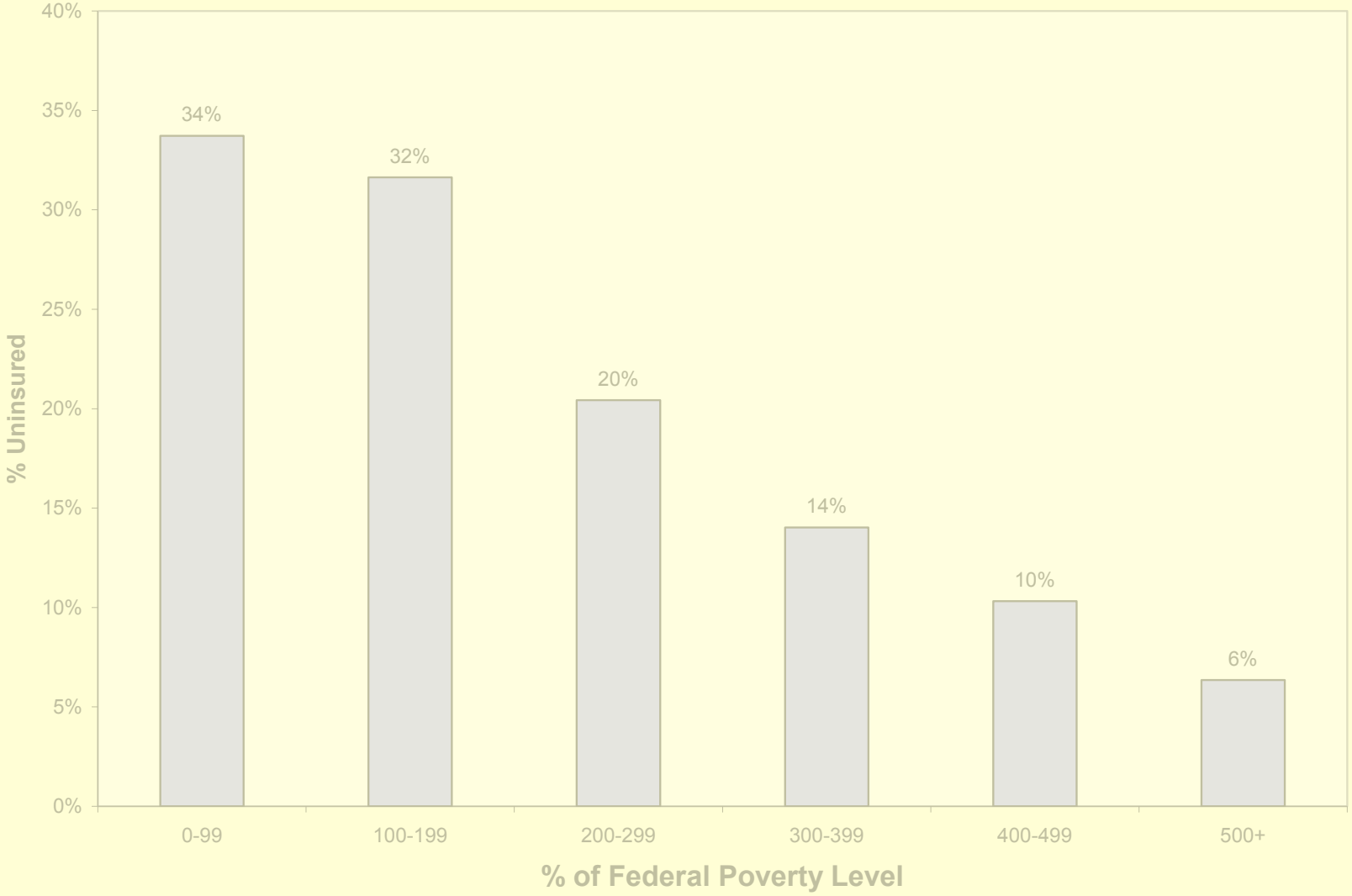
# Central Issue: How Large a Plan?

- **CBO projects cost of final bill at ~ $900 billion from 2010-19**
  - 32 million more with health insurance by 2018 than w/no reform
  - 60 percent reduction in number uninsured
- **Could have been much larger or smaller depending on:**
  - Generosity of premium and cost-sharing subsidies
  - Number of individuals covered (e.g. up to 300% or 400% of FPL?)
  - Inclusion of public plan (especially if it used Medicare rates)
  - Other provisions – federal Medicaid assistance, individual mandate, etc.
- **President made clear – must reduce the budget deficit**
  - Very different from Medicare Part D
  - Thus any increase in expenditures needed to be matched with lower spending and/or higher taxes elsewhere – every $ controversial
- **Progressives and fiscal conservatives had very different views**

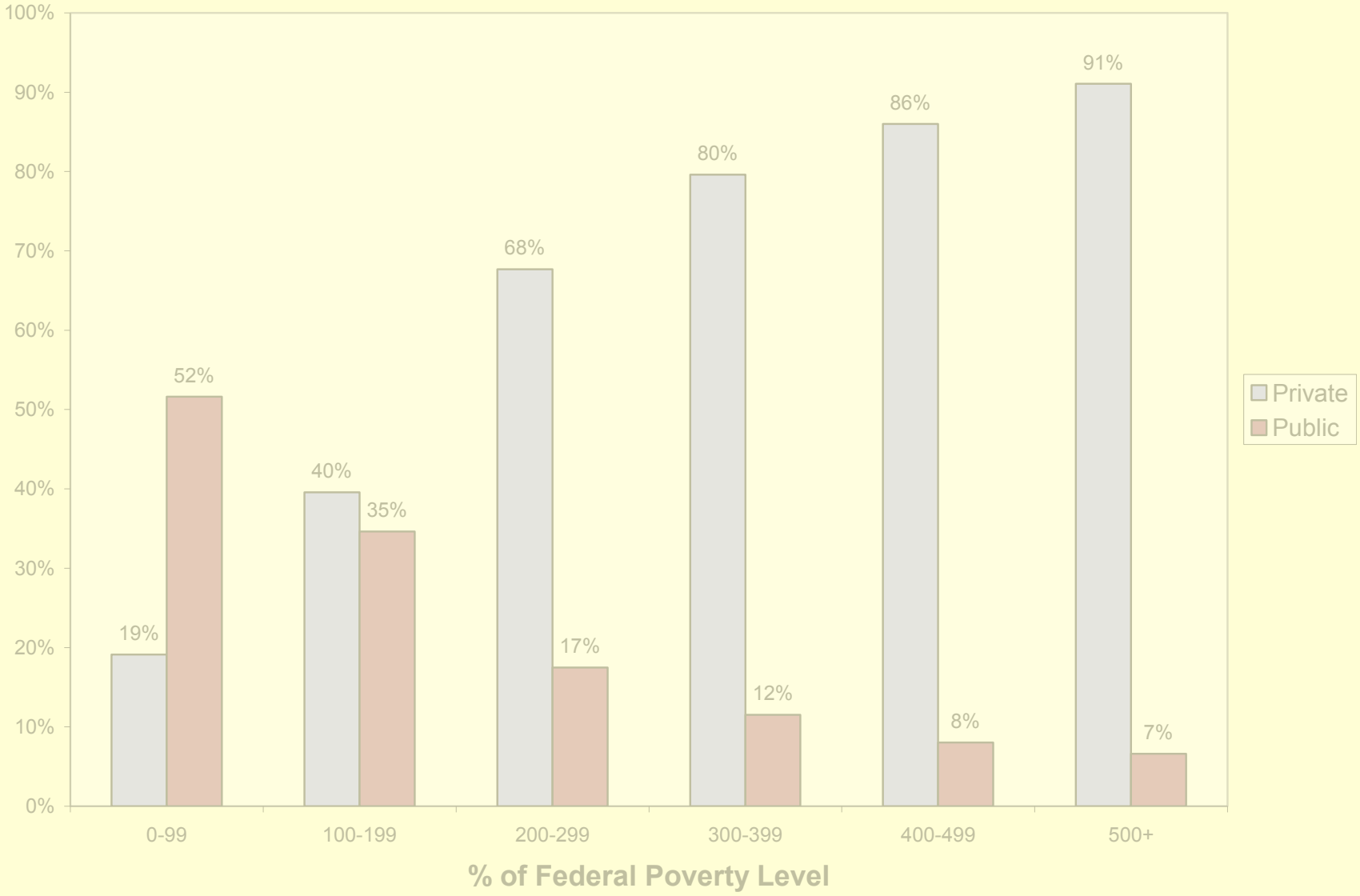
# Key Provisions of Reform: Health Insurance Coverage

- **Medicaid expansions up to 133 percent of FPL**
  - Accounts for half (16 million) of projected net increase in coverage
  - Financed almost entirely by federal government
- **State-based health insurance exchanges**
  - Private insurance policies available with varying levels of generosity
  - Sliding-scale premium subsidies from 133 - 400 percent of FPL – phaseout (marginal tax) rate of almost 15 percentage points
  - No public plan but insurers have incentive to price competitively b/c consumers pay full cost on margin for more expensive plans
- **Small business tax credit for low-wage firms with <25 FTEs**
- **Individual mandate – penalty if individuals without coverage**
- **Employer responsibility for firms with 50+ FTEs**
  - To reduce crowdout of existing ESI coverage

# Those with Low Incomes more Likely to be Uninsured



# Public and Private Coverage also varies with Income



# Key Provisions of Reform: Financing

- **PPACA projected to reduce deficit by $140 billion from 2010-19**
- **Changes to Medicare – 3 largest ones include**
  - Reduced "overpayments" to private Medicare Advantage plans
  - Reduce annual update for hospital, HHA, SNF reimbursement rates
  - IPAB – Independent Payment Advisory Board – modeled after Fed
- **Excise tax on high-premium plans – delayed until 2018**
  - Insurer pays tax above certain thresholds, which grow at CPI
- **Other sources of revenue**
  - Increased tax on unearned income and on high-income individuals
  - Device, pharma, and insurer fees in proportion to firm mkt share
- **Potential unintended consequences of these changes**

# Key Provisions of Reform: Insurance Market Reforms

- **Prohibition of rescissions, except in cases of fraud**
- **No lifetime or annual limits (phased in through 2014)**
- **Coverage of certain preventive services with no cost-sharing**
- **Extension of coverage for adult children through 26th birthday**
- **No pre-existing condition exclusions for children**
- **State high-risk pools for adults with pre-existing conditions**
  - Rates are subsidized to make it more affordable
- **Regulation of MLR (medical loss ratio)**
  - Must exceed 85% for large plans and 80% for smaller plans

# Changes in Medicare Financing

- **Reform less popular w/47 million Medicare recipients**
  - Mostly 65+ but also those on Social Security Disability Insurance
  - About $450 billion in lower spending from 2010-19 (6% of total Medicare spending and almost half of PPACA financing)
- **Reductions in annual updates for:**
  - Hospitals, skilled nursing facilities, and home health agencies
- **Reductions in overpayments to Medicare Advantage plans**
  - Private insurers that Medicare contracts with to coordinate care
- **Independent Payment Advisory Board – modeled after Fed**
- **No significant changes in cost-sharing or in Medicare eligibility**
- **Enhanced benefits by gradually filling Part D "donut hole"**

# Variation across States in MA Penetration: July 2010

**Top Fifteen States**

| *State* | *# Recipients* | *% in MA* |
|---|---|---|
| Oregon | 612,605 | 42.2% |
| Minnesota | 780,432 | 42.1% |
| Hawaii | 205,375 | 41.8% |
| Arizona | 866,980 | 38.8% |
| Pennsylvania | 2,267,735 | 38.4% |
| California | 4,709,192 | 35.8% |
| Rhode Island | 181,899 | 34.8% |
| Colorado | 615,045 | 34.0% |
| Utah | 280,512 | 34.0% |
| Ohio | 1,889,204 | 33.4% |
| Nevada | 350,740 | 30.9% |
| Florida | 3,318,065 | 30.7% |
| New York | 2,975,609 | 30.4% |
| Wisconsin | 905,041 | 29.4% |
| Idaho | 227,154 | 29.3% |

**Bottom Fifteen States**

| *State* | *# Recipients* | *% in MA* |
|---|---|---|
| Alaska | 65,397 | 0.6% |
| Delaware | 148,081 | 3.6% |
| Vermont | 110,806 | 4.3% |
| Wyoming | 79,803 | 6.7% |
| New Hampshire | 216,733 | 7.2% |
| South Dakota | 136,057 | 8.0% |
| Maryland | 780,015 | 8.1% |
| North Dakota | 108,328 | 8.2% |
| Mississippi | 494,139 | 9.5% |
| Illinois | 1,832,628 | 9.7% |
| Washington D.C. | 77,699 | 9.9% |
| Kansas | 431,429 | 10.9% |
| Nebraska | 278,385 | 12.0% |
| New Jersey | 1,322,283 | 12.6% |
| Maine | 263,617 | 12.7% |

# Medicaid Expansion

- **Medicaid is state-administered but federal-state financed**
  - Federal share varies from 50% (e.g. CT) to ~75 percent (e.g. WV)
- **Currently insures more than 50 million U.S. residents**
- **Reform expands Medicaid coverage up to 133% of FPL**
  - CBO projects 16 million more in Medicaid by 2016 as a result
  - Will affect some states much more than others
- **State fiscal difficulties led to much greater federal match (100% initially, later ~90%) for those made newly eligible**
  - CEA report: states better off given drop in uncompensated care
- **Unfair to those states that had already expanded coverage?**
- **Different match for expansion and existing recipients**

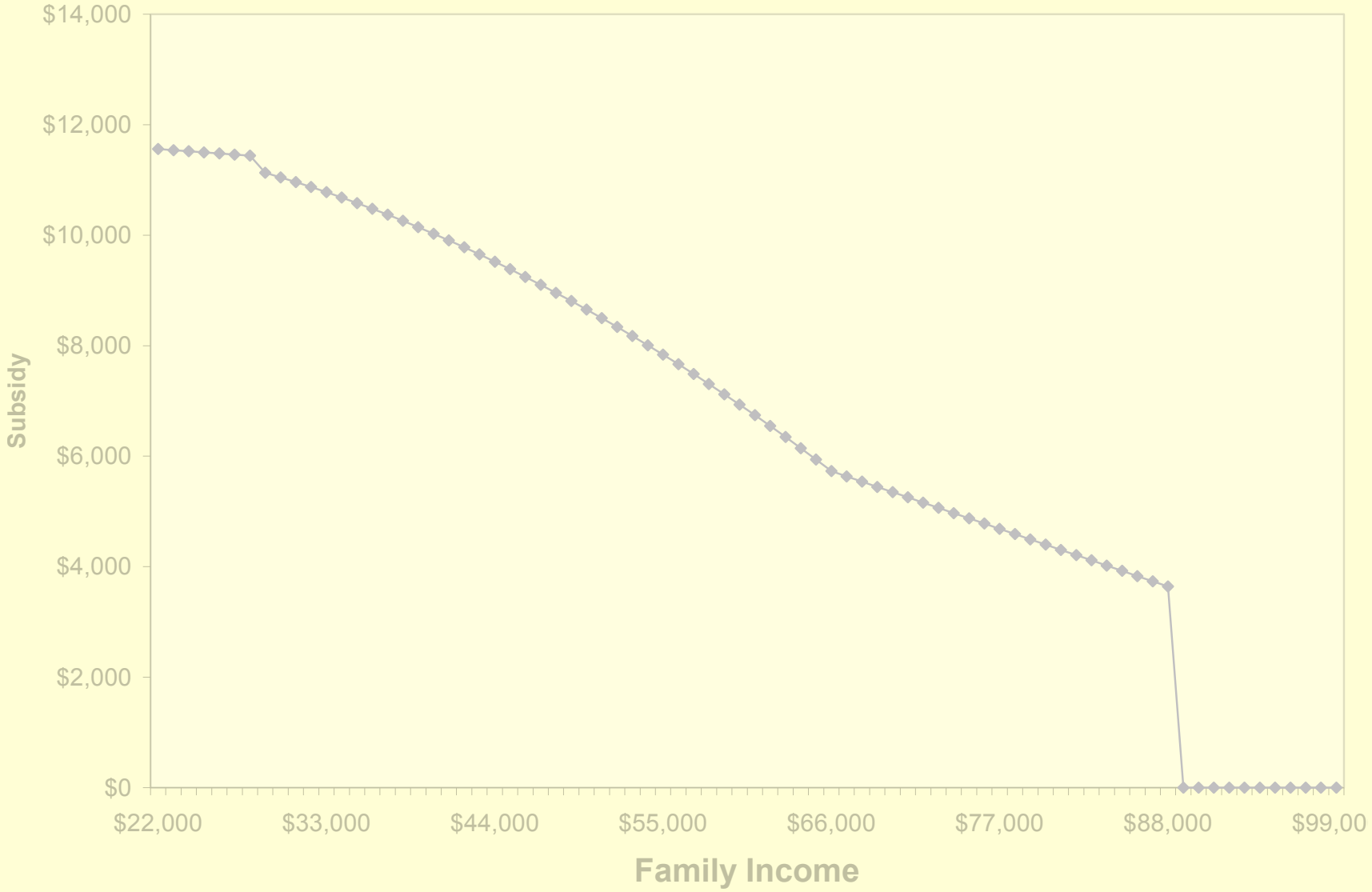
# Individual Mandate and Employer Responsibility

- **Individual mandate one of the more controversial provisions**
  - Penalty if person is without creditable insurance coverage
  - Small initially ($95 or 1% of income in 2014) and grows over time to maximum of $695 (per person) or 2.5 percent of income in 2016
  - Included to increase coverage and reduce strategic behavior (e.g. sign up for subsidized coverage only when sick)
  - Being challenged right now in court as unconstitutional
- **Employer responsibility controversial as well**
  - Penalty if employer does not offer creditable coverage to workers
  - Employers with <50 full-time employees exempt from requirements
  - $2,000 penalty per full-time employee if firm does not offer
  - Absent this provision, many firms would drop coverage

# Generosity of Subsidies in the Exchange

- **Those <400% of FPL ($88k for family of 4) subsidy-eligible**
  - 63 percent of non-elderly were <400% FPL in 2009
- **CBO projects 24 million will enroll in exchanges**
- **Premium subsidies so that:**
  - Person at 133% of FPL pays 3 percent of income for base plan
  - Those from 300-400% pay 9.5 percent
  - Subsidy cliffs at 400% if premiums are somewhat high
  - Introduces substantial marginal tax rates as subsidies phase out
- **Cost-sharing subsidies increase actuarial value (AV) of plans**
  - Share of costs paid for by plan
- **Changes in subsidy generosity and in range of incomes covered had huge impact on projected cost of reform**
- **Difficult economic tradeoffs b/w phase-out rate, existence of subsidy cliffs, share of population affected, etc. – easiest to show graphically**

# Subsidy in Exchange for Family of Four with $12,000 Policy



# Excise Tax on High-Cost Plans

- **Primary lever for "bending the cost curve" in private sector**
  - Current tax subsidy to ESI leads to policies that are "too generous"
- **Levied on insurers rather than individuals**
  - Could alternatively have capped amount of ESI deduction on the 1040
- **Tax paid on amount beyond threshold**
  - On margin, should reduce amount spent on health insurance
  - Employers likely to respond by raising wages – thus more tax revenue
  - Opponents of this provision are skeptical that this will occur
- **Delayed until 2018 and then threshold grows with CPI**
  - Thus ever-increasing share of plans will hit it
  - Initially only 5-10 percent affected
- **One of the most contentious of all provisions in reform**

# Public Plan

- **A potential alternative to private plans in exchanges**
  - Proponents argued it would introduce more competition
  - Could lower premiums directly (using Medicare rates) and indirectly
  - CBO projected up to $150 billion in savings from 2010-19
- **Perhaps the most controversial of all reform provisions**
  - Heightened fears about "government takeover"
  - Concerns about adverse selection into public plan
  - Opponents feared a first step to single payer
- **Strongly supported by more liberal Democrats**
  - Howard Dean, Health Care for America Now, etc. supported
  - Included in the House bill but not in Senate bill
  - Lieberman was pivotal in Senate – needed 60 votes
  - Did not end up in PPACA

# Other Controversial Issues

- **"Death panels" – rising criticism during summer recess**
  - Grassley's famous "pull the plug on Grandma" quote
- **Abortion – very difficult to reach compromise**
  - Catholic Bishops and other groups wanted no funding of abortions in exchange plans
  - Bart Stupak, Louise Slaughter, and others
  - House language more restrictive than Senate
- **"Government takeover" of health care**
- **Would it stimulate or dampen job growth?**
  - CEA's "The Economic Case for Health Care Reform"

# PPACA Ultimately Passed – Now What Lies Ahead . . .

- **"Early deliverables" are being implemented**
  - Not all working as predicted (e.g. enrollment in high-risk pools)
  - But others have had expected impact – young adult coverage
- **Lawsuits working their way through the courts**
- **Number uninsured continues to grow – 51 million in 2010**
- **Premiums rose rapidly last year – by 9 percent**
  - Partly the result of ACA? Requiring preventive coverage, coverage of young adult children, etc.
- **Challenges for state-based health insurance exchanges**
  - Risk adjustment, optimize shopping experience, subsidy determination, etc.
- **State fiscal difficulties and Medicaid expansions**

# What will Happen to Health Care Cost Growth?

- **Currently 17.5 percent of GDP and steadily growing**
  - Government share is approximately half
- **CMS projects a slowdown in public sector expenditures**
  - Relies crucially on whether Medicare savings are realized
  - Costs of the Medicaid expansion – 25% on Medicaid in 2015
  - Employer dropping could greatly increase gov't subsidies
  - Demographic change will significantly increase Medicare expenditures
- **Delivery system reforms – bundled payments, ACOs, etc.**
  - Will these work as expected?
- **Private sector costs will be smaller share in years ahead**
  - Will the excise tax remain in effect?
  - Will exchange make consumers more price conscious?
  - Willingness of consumers to accept (a) narrower provider networks (b) more cost-sharing (c) fewer services covered?

# Timeline along the way to 218 House & 60 Senate Votes

- **CBO scores enormously influential – the ultimate arbiter**
  - Projections on total cost, # covered, deficit reduction, etc.
- **Senate HELP Committee and three House committees pass bills in the summer of 2009**
  - Wait for Senate Finance Committee and "Gang of Six" begins
  - SFC finally passes bill in October 2009 (with Snowe vote)
- **House passes bill with 220 votes (with one R vote)**
  - Abortion deal the final issue
- **Senate passes bill with exactly 60 votes on Christmas eve**
  - Joe Lieberman and Ben Nelson the last ones to sign on
  - Abortion, public plan, Medicaid financing, total cost

# January of 2010 and the Scott Brown Victory

- **House and Senate hammering out differences between their two bills in early 2010**
  - Still would need 218 and 60 votes so little margin for error
- **Special election to fill Ted Kennedy's seat**
  - Taken as a given that Coakley (the Democratic nominee) would win
- **Scott Brown wins bringing Democrats to "just 59" in Senate**
  - Health reform's prospects thought to be essentially finished after reaching the proverbial "two-yard line"
- **Time to focus on economy and other issues**

# The Path to Passage – the Reconciliation Process

- **House could pass Senate bill with simple majority**
  - President could then sign this into law
- **Then make changes through reconciliation**
  - Only 50 Senate (and still 218 House) votes needed there
  - But not all provisions can be changed through this (e.g. abortion)
- **House Republican retreat in February**
  - President back "on his game"
- **Huge premium hikes (39%) by WellPoint in CA**
  - Reminded voters and Congress of need for reform
- **Able to work out key issues**
  - Excise tax and abortion loomed largest