‘Here There Be Dragons’

By Jeff Goldsmith *Tue, Dec 15, 2009*

There is no actuarial roadmap through what could be a completely restructured health insurance marketplace. "It's terra incognita," says this consultant and author.

Last week, the Congressional Budget Office weighed in on the biggest economic imponderable in the health care debate: how private health insurance premiums will behave under health reform.

Building on its December 2008 CBO health insurance market analysis, CBO forecast largely benign effects from health reform’s private market reforms and subsidies on the vast majority of the presently insured (e.g. voting public).

According to CBO, only 17% of Americans in the so-called non-group market—largely individuals—would see premium increases in 2016 (the CBO reference year), because they would be required to purchase fatter benefits with less economic risk.

CBO believes that the other 83% of the presently insured will see little or no change.

I think the fiscal risks of a partially federalized private health benefit are significantly greater than CBO has suggested.

Estimated premium subsidies in proposed legislation—$574 billion over ten years in HR 3962—are pegged to *estimated* private health insurance premiums.

If, as a result of legislative intervention, premiums actually rise by, say, *double* the forecasted rates, Congress will be under fierce political pressure to match the increases, or throw millions of people who depend on subsidies back into the ranks of the uninsured.

Where that additional money would come from in 2016, with trillion-dollar deficits, Social Security transitioning to negative cash flow, and baby boomers flooding onto Medicare, becomes a large question.

What we’re really talking about is trying to predict the fluid dynamics of a $900 billion lake of money—the private insurance premium pool. Lake volume is determined by how private insurers price their products, which, in turn, is determined by how their actuaries forecast both variables that will be politically controlled and variables that are beyond political control.

Terra incognita

Under health reform, the federal government will aggressively restructure insurance underwriting practices. Insurers will be required to:

- Issue policies to anyone who applies.

- Cover an (politically determined) "essential benefit."
- Not cap the benefit for those with catastrophic medical expenses.
- Not charge more than two or three times the least expensive rate to the oldest or sickest in the pool.
- Add people in their 20s to their parents' policies, and a host of other factors.

There is no actuarial roadmap through this completely restructured insurance marketplace. It's *terra incognita,* properly labeled "Here There Be Dragons!"

Health reform will also create a new Boulder Dam to hold back the lake—a system of health insurance exchanges that become the gateway to the private market, not only for those presently uninsured, but also for a large number of the currently insured population. The exchange's rules will be the de facto regulatory hurdle health plans will have to surmount to reach the rest of us.

Some humility is appropriate here for all forecasters: the behavior of that lake of money is a classic complex phenomenon.

Benign assumptions

For all the comforting semblance of objectivity, the CBO's analysis is just a guess—an educated guess—about how the lake will behave if you completely restructure its boundaries. You can model the heck out of it, but all you really do is reframe your uncertainties.

CBO makes some truly debatable assumptions that lead to their benign forecast:

- That there is little provider cost shifting in the present market, and will be less in the future because of all the newly covered folks.
- That there will be limited risk selection risk from those who take up coverage; that more healthy people will take up coverage in the most volatile non-group segment because of premium subsidies.
- That there will be only modest increases in health care use due to the legislatively mandated reduction in cost sharing by subscribers.
- That there will be little or no inflationary impact on health care prices of increased demand for health care from the uninsured.

It is actually hard to construct a rosier scenario than the one CBO created.

What's really happening

Let's contrast CBO's rosy scenario with what's happening right now in the market segments with the greatest risk-individual and small-group coverage.

Presently, the private insurance cost trend is between 8% and 9% across the health system, and rising. Large groups are seeing rate quotes for 2010 below that number. Individual and small-group clients are seeing mid-to high teen rate increases for 2010.

What accounts for the widening spread between inflation and health costs, and between cost and rate quotes, in the non-group market segment that health reform will restructure?

Actual health care demand—hospital admissions, physician visits, prescriptions filled—remains pretty soggy (flat or low single digits), so whatever is pushing up rates isn't driven by primary demand.

Why rates run ahead of costs or inflation

Cost shifting is certainly a rising contributor to both spreads—cost above inflation and rates above cost.

CBO seems to think that just because providers charge insurers higher rates than Medicare and Medicaid doesn't mean that they are shifting costs. If it weren't for cost shifting, most providers who have margins wouldn't have them. Private insurance is where all their profits come from.

When Medicare flattened costs under the Balanced Budget Act (BBA) in 1997, the result was a lagged surge in private insurer costs, which peaked in 2003. Coincidence? I don't think so.

I and my consulting colleagues have spent this fall telling providers that it's time to learn to make money at Medicare rates, because health reform could eventually force insurers to restructure their contracts or cap their rates.

Another contributor to the spread between the 8-9% cost trend and mid- to high-teen rate increases is the effort by insurers to float their overhead (which is being whittled away at, rather than energetically cut) on a smaller base of profitable risk business.

These plans may have lost as many as nine million risk lives in the past two awful years, and if it were not for hefty Medicare Advantage enrollment gains, a lot of the bigger plans would be in a heap of trouble.

Since Medicare Advantage margins will be sharply cut by health reform, we may be seeing some anticipatory rate increases to small-group and individual subscribers.

Lake Mead of money

All in all, the fiscal risks from an open-ended new entitlement to premium subsidies are likely to be significantly larger than CBO estimates.

Instead of neat economic models with ten variables, we need something closer to chaos theory to explain how the nearly trillion-dollar Lake Mead of money will behave when we completely re-engineer its flow pattern. Perhaps the Corps of Engineers can lend CBO some staff.

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