PREFACE

The third edition continues the general organization introduced in the first edition and continued in the second. This new edition has been completely updated to reflect the implementation of the Affordable Care Act (ACA). This evolution turns out to mean a lot more than simply describing the provisions of the law, which we do in chapter 2, and discussing the implications for the individual market and Medicaid, as we do in chapters 19 and 24. The implementation of the ACA affects virtually all of the chapters as we deal with adverse selection, underwriting, selective contracting, and the formation of networks, not to mention insurance competition and Medicare. Even the chapter on compensating differentials is affected as we think about the effects of the mandate that children under 26 be included in employer-sponsored family coverage. Following is a description of each chapter in the book, with a focus on this edition’s new material.

Chapter 1: History of Health Insurance in the United States

This chapter’s history of health insurance in the United States remains largely unchanged. However, the breakdown of voting for Medicare and Medicaid in 1965 is now included to speak discreetly to the bipartisan nature of that legislation. The chapter now includes the political history of the ACA’s enactment. The exhibits here and throughout the book have been updated wherever necessary to reflect the most recent data.

Chapter 2: The Affordable Care Act

This chapter is new. It builds on the material that was present in chapter 3 of the prior edition and selected elements from elsewhere in that edition. The chapter devotes considerable attention to the nature of the premium subsidies and how income, higher premiums, and the premium of the second-cheapest silver plan affect subsidies. In also discusses the cost-sharing subsidies and
the effects that the elimination of funding had on them. Given several years of experience with the ACA, the chapter provides up-to-date data on enrollment trends and premiums as well as findings from the empirical research on the broad effects of the law. The discussion of the functioning of exchanges that formed a distinct chapter in the prior edition has been pared back substantially and included here. The Medicaid expansion is discussed. The chapter devotes considerable new attention to the rollout of the exchanges and the trends in insurer offerings and premiums. This chapter was moved up in the text to provide both continuity with the history chapter and background for ACA-related discussions in virtually every other chapter.

**Chapter 3: A Summary of Insurance Coverage**

This chapter is almost totally rewritten. The prior edition only included pre-ACA enrollment discussions. The revised chapter largely focuses on 2013 and 2017 data to facilitate pre- and post-ACA comparison. Employer-sponsored, individual nongroup, Medicare, and Medicaid coverage are still featured. The chapter now gives greater attention to the changes in the number of uninsured and their distribution across the states.

**Chapter 4: The Demand for Insurance**

This chapter remains largely intact, focusing on the Friedman-Savage model of insurance.

**Chapter 5: Adverse Selection**

This chapter remains largely unchanged. The shift to managed care continues to be the mechanism used to discuss adverse selection. As the chapter ends there is a discussion of field research, which suggests that the withdrawal of insurers from the exchanges was the result of much greater adverse selection than anticipated.

**Chapter 6: Underwriting and Rate Making**

The key elements of chapter 6’s discussion of underwriting have been retained. This serves as background for the pre-ACA period and as an element for future short-term policy offerings. The important discussion of large group experience rating and the evolution toward self-insured plans
Chapter 7: Risk Adjustment

This chapter remains intact. The Medicare model used to pay Medicare Advantage plans continues to be used as the vehicle to discuss risk adjustment—the data and methods are readily available, and the model, with some additions, is now used in the ACA risk adjustment process. A new section of the ACA’s risk adjustment and transitional adjustment mechanisms is now included.

Chapter 8: Moral Hazard and Prices

This chapter presents the RAND Health Insurance Experiment and related, generally reinforcing studies. There is an expanded discussion of value-based health insurance and new work on the effects of deductibles. A new section on the Oregon Medicaid Experiment also has been added.

Chapter 9: Utilization Management

This chapter continues to report and evaluate the relatively modest literature on the effects of utilization management. There is a relatively large new section discussing the effects of wellness programs.

Chapter 10: Managed Care, Selective Contracting, and the Insurance Industry

This chapter remains intact, building on the initial selective contracting effects in California and then generalizing the findings with more recent studies from elsewhere in the country. The discussion of centers of excellence and reference pricing has been expanded substantially to report the findings of recent research evaluating their effectiveness.
Chapter 11: Provider Consolidation, Monopsony Power, and the Managed Care Backlash

The emphasis in this chapter has shifted away from the managed care backlash to devote more attention to competition among hospitals and physicians. The examples of Federal Trade Commission actions against hospital mergers and provider marketing groups are updated. Of particular importance is the addition of new research on the effects on prices of hospital and physician market concentration. The chapter continues to end with a discussion of insurer monopsony power designed to set up the next chapter.

Chapter 12: Insurance Market Structure, Conduct, and Performance

This chapter has been completely revised. The original chapter was a new and unique component of the second edition. Since that writing, significant new descriptive and analytical work has been done on the health insurance industry. As a result, the first half of the chapter has been revised to reflect a better and more timely characterization of health insurance market structure. This change includes a new discussion of the failed Aetna-Humana and Cigna-Anthem mergers. The analysis of the research on the effects of consolidation in the industry remains. A new section examining the impact of Blue Cross Blue Shield conversions from not-for-profit to for-profit status has been added, and much of the discussion of the magnitude of the effects of industry consolidation has been reorganized.

Chapter 13: Premium Sensitivity and Health Insurance

This chapter continues to present the research on the extent of price sensitivity in the purchase of employer-sponsored coverage. Most of this work focuses on worker willingness to change plans in the face of changing out-of-pocket premiums. The discussion of employer willingness to offer coverage has been revised and a short section on the effect of the ACA on willingness of employers to offer coverage has been added.

Chapter 14: Compensating Differentials

This chapter is key to the text. It remains largely unchanged, focusing on the evidence that workers pay for health insurance in the form of lower wages or other reductions in benefits. Two new sections have been added.
The first examines the effects of the ACA provision that young adults under 26 can be covered under their parents’ employer-sponsored coverage. The evidence suggests that wages adjusted downward to accomplish this increase in coverage. The second new discussion examines the extent of compensating differentials in the government sector. New empirical work finds that the economic incentives for compensating differentials are less rigid in the public sector and wage reductions do not fully account for increased health benefits.

Chapter 15: Taxes and Employer-Sponsored Health Insurance

The thrust of this chapter remains unchanged, but tax law changes in the ACA and in the 2018 tax reforms shifted marginal tax rates in important ways. These changes are now incorporated into the analysis of the magnitudes of the effects of tax policy on employer-sponsored health insurance. As a result, much of the chapter has been updated. A discussion the ACA’s Cadillac Tax continues to be included, but the ongoing delay in its implementation is now also discussed.

Chapter 16: Employers as Agents

As before, this chapter discusses issues faced by employers as they seek to provide health insurance. The chapter begins with the value that workers put on health insurance. However, new research suggests that workers are not as happy with the mix of wages and benefits as they once were. A new detailed discussion of exchanges for private health insurance (perhaps better thought of as defined-contribution health plans), has been added. A major addition to the chapter is an examination of workers’ ability to make informed health plan choices. New research finds significant gaps in their ability to choose wisely and offers mechanisms that employers can use to enhance decision-making.

Chapter 17: Health Savings Accounts and Consumer-Directed Health Plans

This chapter continues to describe how health savings accounts and consumer-directed health plans work. Data on the growth in enrollment, sizes of deductibles, and maximum out-of-pocket costs, and research on who enrolls and the magnitude of changes in utilization and spending, have all been substantially updated.
Chapter 18: The Small-Group Market

This chapter describes the small-group market. It continues to make the point that firms with fewer than 50 workers are the ones least likely to offer coverage and are largely unaffected by the ACA. The data on enrollment and the limited role of the ACA have been added. The discussion of association health plans has been reworked in light of the Trump administration’s encouragement of these options.

Chapter 19: The Individual Insurance Market

This chapter has been largely rewritten. It presents updated information on enrollment in the exchanges and the characteristics of those enrolled. A major addition is analysis of new research on the high degree of price sensitivity in this market segment. These findings are used to analyze the effects of the large premium increases in the exchange marketplaces and the differential effects on those with and without subsidies. New data on the extent of competition in the market are now discussed at some length. Given the role of preexisting conditions in the individual market, a new section on the prevalence of these conditions and market response is now included. New sections on healthcare-sharing ministries and the short-term market have been added.

Chapter 20: Health Insurance Regulation

This chapter provides an overview of federal regulations, but most of the attention is on state regulation, particularly coverage mandates. The discussion of interstate competition has been fully revised, with a focus on the importance of provider network formation.

Chapter 21: High-Risk Pools

This chapter has been retained essentially as optional reading. Those who propose fundamental changes to the ACA, or to replace it altogether, often use high-risk pools as a mechanism to provide coverage for those with preexisting conditions. The motivation for the discussion has been rewritten but the characteristics of the state programs continue to be presented.

Chapter 22: An Overview of Medicare

The discussion of the Medicare program has been updated to reflect current tax rates, premiums, deductibles, and coinsurance rates, including Part D standard
coverage. (The tax rate changes, of course, where legislated through the ACA.) A new discussion of beneficiary decision-making has been added. The discussion of the future of Social Security and Medicare has been updated as well.

**Chapter 23: Retiree Coverage**

Chapter 23’s discussions of Medicare Advantage (MA), employer-sponsored retiree coverage, and Medigap coverage have all been updated. This revision reflects greater MA enrollment, the declining importance of employer-provided retiree coverage, the growing reliance of MA on employers’ retiree offerings, and changes in Medigap stemming from government policy changes. New research on the effects of supplemental coverages on Medicare spending has been added. A new section on the effects of the ACA on Medicare Advantage plan enrollment is newly included.

**Chapter 24: Medicaid, Crowd-Out, and Long-Term Care Insurance**

Much of this chapter has been updated. Under the ACA, Medicaid and CHIP enrollment are determined by MAGI (modified adjusted gross income). This new approach to defining eligibility is now included. The discussion of the variability in eligibility and generosity has been expanded and examples of differences across states and categories of eligibility are now included. Enrollment and spending across eligibility groups has been updated and reflects post-ACA values.

**Epilogue**

The epilogue remains unchanged. In some ways it is the most important element of the book. I tell my students on day 1 that we will examine health insurance, often in significant detail. But they are to appreciate that there are only a handful of key, but enduring, themes. The epilogue is to remind them of those themes. I close my course with the line: “If this course was successful, every time you come across an insurance issue, you’re going to say, ‘Wait a minute, isn’t there an adverse selection problem?’, ‘. . . isn’t there a compensating differential issue?’, and so on.”

**Teaching with This Textbook**

I have used this book in a variety of settings, all at the master’s or doctoral levels—although colleagues at other universities have told me they have
used it successfully in upper-division undergraduate courses. In a standard 15-week semester, most chapters can be presented in a single 75-minute class period. The history and ACA chapters typically take a bit longer, in part because the first class period also must deal with course administration. Chapter 4 on the theory of insurance takes less time. I always present that material with coin flips and questions about whether the students would take, say $500 or a 50/50 flip of a coin for $1,000 or $0. I then formalize the theory with freehand whiteboard graphs. In my experience, the time it takes for me to struggle through the bad drawings is enough time for the students to understand the contest. If I just walk through the four hypotheses with PowerPoint slides of the graphs, it doesn’t seem to register with them. In the many years that I have taught this course, I have never required a prerequisite. One could require a health economics course, or perhaps more important, a business statistics course. Most of my students do already have these prerequisites, but those that don’t have these courses tend to do just as well.

Each chapter ends with a summary and a series of questions. I encourage the students to review the summary before they read the chapter. While the questions could be given as take-home assignments, I exclusively use them for in-class discussions. The questions serve a variety of purposes. They may simply call for an application of a concept from the chapter to a specific management of policy issue. These are generally straightforward and easy for students to answer. Other questions serve to introduce future chapters. These are obviously harder to answer and will be frustrating if assigned without discussion. Other questions ask students to recall earlier topics and to apply them with more nuance now that they have seen new, complicating factors.

When I teach executive master’s degree or doctoral courses, I typically assign blogs that require approximately ten students to participate for each question. These might include topics such as price transparency, surprise billing, the effectiveness of wellness programs, evaluating a current hot topic such as Medicare for all or Medicaid block grants. These topics can be set up in a variety of ways. Price transparency, for example, could involve a discussion of the Centers for Medicare & Medicaid proposal to release negotiated prices or what efforts their organizations have made to enhance price transparency for their patients.

**Acknowledgments**

There are, of course, many people to thank. The first are the students over the last 30 years who have raised new and interesting issues. They ask “yes, but . . .” questions. They bring in personal and work-related experiences. They
ask what new policy proposals imply or what new management initiatives will do. These topics find their way into the text, or the end-of-chapter questions, or sometimes midterm questions. The discussion of healthcare-sharing ministries in this edition, for example, came about because a student said she was talking to a neighbor who had such coverage, and the student thought it sounded like the old sickness funds. Thanks are due to Jack Nelson, who critically reviewed the ACA chapter, and to Dick Nathan, who led me into a series of field studies of ACA implementation. I learned a lot because of his insistence that we do this. I also need to thank my faculty colleagues in the Department of Health Policy and Management at Texas A&M. They showed good grace as their department head disappeared on many afternoons to revise and rewrite book chapters.

Janet Davis, the acquisitions manager at Health Administration Press, has worked with me on all three editions. She has been wonderful in encouraging each edition, in letting me do odd things like having two indexes, and in accommodating my delays. (It turns out that selected afternoons away from the office do not provide enough time to actually do a textbook revision!) Many thanks are due to Theresa L. Rothschadl, who served as my copy editor. She exercised a light hand and let my voice appear on the page. She highlighted the many times when my explanations were not clear and helped me fix them. She also worked diligently to teach me that the pronoun “this” does not serve as the subject of a sentence. I hope that she does write the novel in which the apparently unusual names of some economists and health services researchers become prominent characters.

Finally, thanks to my wife, Elaine. She has been ever supportive, even at the loss of many Sunday afternoons, and commented on the new chapters. As was said in my dissertation many years ago: “May profits always be hers.”

Instructor Resources

This book’s Instructor Resources include discussion guides for the end-of-chapter questions and PowerPoint slides.

For the most up-to-date information about this book and its Instructor Resources, go to ache.org/HAP and browse for the book’s title, author name, or its order code, 24091.

This book’s Instructor Resources are available to instructors who adopt this book for use in their course. For access information, please email hapbooks@ache.org.