PREFACE

This book is designed for master's students in health administration, health policy, and public health programs. It is also useful as a foundation text in doctoral health services research and health economics programs. Courses in those programs, of course, would supplement the text with original research material. The text will also work well as an upper-division undergraduate health insurance course in an economics, business, public health, or public policy curriculum. In addition, physicians and residents who have taken my course argue that the book should be required reading for their clinical colleagues.

The text presents a rigorous but intuitive examination of the issues raised by insurance and how the market and the government have dealt with these issues. The emphasis is on understanding the underlying problems from an economics perspective and then applying the empirical literature to provide insight into the impact and effectiveness of the solutions. When the evidence is equivocal, that is made clear in the text. As a result, this is not a text for those interested in the day-to-day operations of insurers. Rather, the perspective is that of one looking in from the outside, trying to understand the role that private health insurance plays in the United States. As such, it serves as a basis for understanding and predicting the effects of the 2010 Patient Protection and Affordable Care Act (ACA).

This emphasis on intuitive understanding is important to success. The vast majority of students will not go on to be researchers, actuaries, or even insurance executives. They will buy insurance for their families and worry about coverage for their employees. Most will work as healthcare providers or in organizations that provide healthcare; they will be concerned about how they are paid by private and public insurers. As citizens, policymakers, and those in a position to influence policymakers, they will want to understand how innovations in insurance delivery, in government policy, and in healthcare reform will affect them. An intuitive understanding of the problems and solutions and a general appreciation for what we know empirically will allow them to make more informed decisions and to cast a much more critical eye on proposed solutions.

The programs in which I teach have always regarded this course as essentially a second course in health economics. A first course in health

economics is nominally a prerequisite. However, a reader with some grounding in microeconomics or with a healthcare professional's working knowledge of the US healthcare system will have no difficulty mastering most of the material presented. The reader will benefit from some understanding of statistics—particularly an appreciation of ordinary least squares regression. There are no direct discussions of econometric techniques. What discussion there is of statistical methods is made in passing as I present the findings of particular studies. The underlying economics and statistics are tools used here to organize thinking and to appreciate the difficulties of obtaining estimates of the magnitudes of the effects of managerial and policy decisions.

New in the Second Edition

The text has been substantially revised, updated, and expanded. Much of this comes as a result of the ACA. Two new chapters dealing exclusively with the legislation have been added, as have discussions germane to topics throughout the text. In addition, new empirical research that has appeared in the past five years has been woven into the discussions. Finally, each chapter now contains a handful of resources for the interested reader. Sometimes these are classic insurance readings; more typically they are recent research papers that make important contributions to the topics covered in the chapter. Significant changes include:

- *Chapter 1: History of Health Insurance in the United States.* The chapter adds new material on industrial sickness funds that predate the progressive era and provide better context for the lack of acceptance of compulsory insurance in the 1920s. A major new section discusses the political development of Medicare and Medicaid beginning with the Truman administration and concluding with the creation of the "three-layer cake" of Wilber Mills. The end of the chapter contains an expanded discussion of consumer directed health plans.
- *Chapter 2: A Summary of Insurance Coverage*. This chapter has been totally updated with the most current data on coverage. A short discussion of the extent of coverage for undocumented residents has been added. A new section on the effects of the "great recession" on coverage has also been added.
- *Chapter 3: The Patient Protection and Affordable Care Act (ACA)*. This entirely new chapter summarizes the major insurance components of the law: the individual mandate, the Medicaid expansion and Supreme Court decision, the penalties and subsidies for coverage, the exchanges, and the requirements for small and large employers. The revenue

sources for the law, new taxes, and reductions in Medicare funding are described, as are the spending projections. These revenue and spending estimates reflect the Congressional Budget Office estimates released three days before the law was enacted. This chapter is a bit of a moving target as implementation dates have slipped. However, the description of the law, here and elsewhere remains intact. It will be fun to engage our students in discussions of how, if at all, delays in one or another element of the law affect our analysis of the impacts.

- *Chapter 4: The Demand for Health Insurance*. This chapter is mostly unchanged from the first edition.
- *Chapter 5: Adverse Selection*. New research on the favorable selection effects in Medicare Advantage plans and on adverse selection in employer-sponsored health insurance is now included. In addition, a brief concluding section suggests the adverse selection issues inherent in the ACA. This section sets the stage for discussions in later chapters.
- *Chapter 6: Underwriting and Rate Making*. Greater attention is now paid to insurers' administrative costs, and the medical loss ratio under the ACA is introduced. Finally, after the discussion of self-insured plans, there is a discussion of the potential that some small employers may self-insure to avoid the premium implications of participating in the insurance exchanges.
- *Chapter 7: Risk Adjustment*. Although the substance of this chapter is unchanged, the relevant values used in the example of paying Medicare Advantage plans under the hierarchical condition categories (HCCs) have been updated, as has the review of the literature on the predictive power of risk adjustment. More importantly, the chapter now has new motivation relating to the requirement under the ACA that the insurance exchanges undertake risk adjustment. A new section on the effectiveness of the introduction of the HCCs on reducing favorable selection is now included.
- *Chapter 8: Moral Hazard and Prices*. The discussion of the effects of health insurance on health outcomes has been expanded, as has the discussion of copays and prescription drugs. The concept of *value-based insurance design* is also introduced with a brief discussion of the state of the empirical literature. The chapter concludes with discussions of recent challenges to the RAND Health Insurance Experiment and Finkelstein's work exploring whether large scale expansions of insurance coverage (e.g., the introduction of Medicare) had effects consistent with the RAND experiment.
- *Chapter 9: Utilization Management*. This chapter is largely unchanged. However, there is now an expanded discussion of the effectiveness of disease management and intensive case management programs. A

discussion of the potential of prevention services to reduce healthcare utilization and spending has also been added.

- *Chapter 10: Selective Contracting*. This chapter continues to focus on managed care plans and hospitals but now includes selected materials on managed care plans and physicians that previously constituted a separate chapter. In addition to general updates, the chapter now includes a discussion of Medicaid managed care. The chapter concludes with a discussion of *reference pricing* and *centers of excellence pricing* as new examples of selective contracting.
- *Chapter 11: Managed Care Backlash, Provider Consolidation, and Monopsony Power*. This chapter has been substantially redesigned. It focuses on the consequences of the backlash and provider consolidation on selective contracting success. The discussion of hospital consolidation has been expanded, and new research on the effects of actual hospital mergers on managed care prices is reviewed. New literature on the effects of physician market power and managed care contractual form is also presented. The chapter concludes with a discussion of the distinction between hospital monopoly power and insurer monopsony power. The discussion of *most favored nation clauses* has been moved to the next chapter.
- *Chapter 12: Insurance Market Structure, Conduct, and Performance*. This new chapter discusses the nature of private insurance markets. It reports on the conversions of many Blue Cross and Blue Shield plans to for-profit status and examines the profitability of the largest health insurers. It then looks at research on the concentration of insurers in various segments of the market. This is followed by a review of the new research on the effects of insurer concentration and of insurer mergers on premiums and provider prices. This is followed by the discussion of most favored nation clauses that was found in the first edition.
- *Chapter 13: Premium Sensitivity for Health Insurance*. This chapter is much the same as in the first edition. The major change is the reworking and expansion of the evidence on the decision of workers to take up coverage offered by an employer.
- *Chapter 14: Compensating Differentials*. This chapter continues to provide a comprehensive overview of compensating differentials in employer-sponsored health insurance. The key new material focuses on the effects of obesity and smoking on money wages. This research argues that the mechanism for lower wages flows through higher health insurance claims and, therefore, results in compensating wage differentials.
- *Chapter 15: Taxes and Employer-Sponsored Health Insurance*. Two new features have been added to this chapter. First, proposals to replace

the current tax treatment of employer-sponsored health insurance are considered and the simulation results are presented. Second, the *Cadillac tax* on employer-sponsored health insurance, required by the ACA, is discussed along with the simulations of its effect. The chapter also includes updated tax tables and a rewritten discussion of out-of-pocket premium contributions.

- *Chapter 16: Employers as Agents.* Updated data on employee satisfaction with the wage-benefit tradeoff and new research on worker–employer matching are presented. A new discussion of *defined contribution health insurance* analogous to defined contribution pension plans is also included.
- *Chapter 17: Health Savings Accounts and Consumer-Directed Health Plans.* This chapter has been updated with recent data on enrollment, and significant new research on the effects of high-deductible plans on healthcare spending is presented. The interplay of the ACA and high-deductible plans is discussed.
- *Chapter 18: The Small-Group Market.* The chapter provides updated estimates of the size and nature of the small group market. Considerable attention is given to the effects that the ACA is likely to have on this segment of the market. The discussion of the role of managed care in this market has been reduced and replaced with an expanded emphasis on the role of high-deductible health plans. Importantly, a new section on the roles of agents and brokers has been added.
- *Chapter 19: The Individual Insurance Market.* This chapter has been updated to include discussions of the ACA. It examines the availability of coverage for young adults under their parents' policies and the early effects of the medical loss ratio on the individual market. A new section reviews recent empirical work on price sensitivity in the individual market. Another new section explores the effects of the availability of charity care on the purchase of individual coverage. The discussion of prices of individual coverage available through the Internet has been fully updated.
- *Chapter 20: Health Insurance Regulation.* Two major expansions have been added to this chapter. The first deals with the new research examining the effects of specific insurance mandates on the use of services. The second examines the effects that interstate competition would have on insurance coverage. This topic is presented here because the effects in the literature are driven by differences in state-level insurance regulation.
- *Chapter 21: High-Risk Pools.* This chapter is largely unchanged, although the data on coverage and premiums in selected state

plans have been updated. Importantly, the details of the temporary preexisting condition insurance plan under the ACA are discussed. The chapter remains in the text because high-risk pools are often considered a key component of any non-ACA reform.

- *Chapter 22: Health Insurance Exchanges.* This new chapter describes the health insurance exchanges in some detail. State and federal-default exchanges are discussed in the context of their differential scope of activities and the number of states choosing each approach. The role and structure of the exchanges are presented along with the distribution of states taking each alternative approach. Governance options and the required functions of the exchanges are described. Essential health benefits and benchmark plans are discussed. The subsidies are described in some detail with examples of the size of such subsidies to eligible individuals and small firms. There is also a discussion of the implications for the exchanges if a state does not expand its Medicaid program. The risk adjustment and other mechanisms that the exchanges must use to account for adverse plan selection are discussed. Financing of the exchanges is discussed using cost and fee estimates developed for the Alabama exchange. Finally, the chapter presents simulation results on the number of people likely to be enrolled in the exchanges and the size of premiums that are likely to result from the underwriting provisions required by the ACA.
- *Chapter 23: An Overview of Medicare.* This chapter updates the deductibles, copays, and premium contributions for Medicare from the first edition. It adds a discussion of higher Part B premiums for higher-income seniors both as a matter of substance and to allow a discussion of potential future changes to Medicare. The discussion of Medicare Advantage plans has been moved to this chapter from the retiree coverage chapter because this seems a more natural home. The discussion of Medicare Part D has been expanded significantly. The implications of the ACA on Medicare both in terms of changes to the program and tax law changes are discussed. A new section on the effects of Medicare on health spending and health status has been added. There is also a discussion of Medicare *premium support* as a reform alternative to traditional Medicare.
- *Chapter 24: Retiree Coverage.* This edition pays somewhat less attention to employer-sponsored retiree coverage than in the previous edition, and more attention is given to Medigap plans, particularly focusing on the changes in the plans now available for purchase.
- *Chapter 25: Medicaid, Crowd-Out and Long-Term Care Insurance.* This chapter now devotes more attention to describing the Medicaid program and expands its discussion of the Children's Health

Insurance Plans. It introduces new research on the effects of premium contributions and copayments on children's use of services in these programs. The discussion of Medicaid managed care has also been expanded. A major new section examines the states' option to expand their Medicaid programs under the ACA. This section replaces the earlier discussion of the future of Medicaid.

Teaching with this Textbook

Most chapters can be presented in a single 75-minute class period. Chapters 3, 8, and 22 are probable exceptions because they cover a lot of ground either descriptively or in terms of research findings. Chapter 1 usually takes two periods as well, given the administrative issues that take up part of the first class period.

Each chapter ends with a series of questions for class discussion. These questions could easily be used as take-home assignments, but it is important that they also be discussed or debated in class because there are no necessarily right or wrong answers. The questions serve three purposes: (1) they may call for the application of the concepts developed in the chapter, (2) they may introduce the next chapter, and/or (3) they may require students to recall key concepts from earlier chapters that have a clear application to the current material.

Discussion guides for these questions can be found in a secure area on the Health Administration Press (HAP) website and are available to adopters of this book. For access information, e-mail hapbooks@ache.org.

PowerPoint slides to assist in teaching the course are located in this area. The slides are generally updated annually to keep coverage estimates, prices, and program parameters up to date. In addition, as I add new material to my own course, these slides are included in the updated slide packs. I suspect that there will be substantial additions in the next few years as the ACA plays out and research on its effects is published.

For the most part, throughout the book I have avoided including discussions or analyses of current state or federal reform initiatives. The proposals change rapidly and are likely to be out of date by the time the text is used in the classroom. However, if the material in the text has been mastered, students will be in a position to knowledgeably discuss whatever proposals are currently being debated.

Acknowledgements

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Janet Davis, the acquisitions manager at Health Administration Press, made this edition, like the first, easy to accomplish. I'm particularly grateful for her willingness to consider and often accept my sometimes uncommon stylistic and organizational requests. Many thanks are also due to Amy Carlton, who did the copyediting on this edition. Her light hand and efforts to maintain my voice are greatly appreciated. I am even willing to acknowledge that my use of quotation marks around "terms of art" may have been excessive.

Finally, thanks as always are due to my wife Elaine. She has been ever encouraging of this project, and she read and commented on every chapter. As was said in the dissertation many years ago, "May profits always be hers."