Harris —
This is very rough, but please take a look & tell me what you think.
RWB

DRAFT

**A No-Tax Proposal to Contain Costs and Enhance Access to Private Sector Health Insurance**

It is widely believed that this country is approaching a health insurance crisis. While 85 percent of the population currently has health care coverage, [many people are concerned that they are not insured adequately for a catastrophic illness or injury.] Many are worried that if they lose their job they will join the 30 million people who have no health insurance at all. Others are concerned that their insurance rates will skyrocket if they get sick -- just as the rates for the RNC grew astronomically after Lee Atwater developed a serious illness.

I don't think this holds up. although haven't seen any survey research, or better yet, focus group work. I worried like the Reagan Admin effort to introduce a catastrophic benefit in Medicare and discovery no reaction from seniors until after the bill was passed

Recent polls reflect these twin concerns: Am I <u>really</u> insured if I get sick? What happens if I lose my job and then get sick? This paper presents a proposal to address these concerns without imposing new taxes or otherwise having to raise additional revenues.

The proposal has two components.

1. Enhance consumer choice by allowing employers to opt for a basic high-deductible federally-approved catastrophic care policy instead of the state-regulated insurance policies that include mandates; and

2. Treat all health insurers, including HMOs and PPOs, like common carriers. That is, require that insurance companies:
   - o insure anyone that requests insurance; and
   - o charge all applicants the same price, while allowing some discounts to discourage risky behavior.

## <u>The Proposal</u>

1. <u>Enhance consumer choice by allowing employers to opt for a basic high-deductible federally-approved catastrophic care policy instead of the state-regulated insurance policies that include mandates.</u>

Consumers should have the choice to avoid the cost of state mandated benefits by allowing insurance companies and employers to offer a standard catastrophic health care policy with a high deductible. Federal preemptory legislation would be needed to implement this approach. Rather than define a complex package of services, it might specify that all health care services that cost more than a $1000 for a single event are covered. Beyond the

threshold, the cost of all services would be paid.[1] It is expected that, over time, insurers will choose to offer the (presumably less expensive) catastrophic cost package, and policies with mandated benefits will become more expensive and eventually wither away.[2]

This should reduce the cost of health insurance premiums by eliminating unwanted mandated benefits while offering the type of catastrophic coverage that is truly needed. It would thereby enhance access and reduce the anxiety of citizens that they will not be insured for a catastrophic event. A major drawback is that it would involve some preemption of state insurance regulation, raising federalism concerns.

2. Treat all health insurers, including HMOs and PPOs, like common carriers. That is, require that insurance companies:
   - o insure anyone that requests insurance; and
   - o charge all applicants the same price, while allowing some discounts to discourage risky behavior.

This would require all insurers to act like a common carrier, taking all customers at one price. Insurers could offer discounts from that price to create incentives for consumers to avoid risky behavior, such as smoking.

This would enhance access to health insurance for people at high risk of health problems without raising additional taxes. Rather than have the government cross-subsidize risks through the tax code, as Heritage and others propose, consumers will cross-subsidize risks through insurance premiums. In so doing, the catastrophic package would cost more than it otherwise would for low-risk consumers, but it is still likely to cost less than the current mandated benefit package that states now require.

The disadvantage of this proposal is that it would reduce the efficiency of insurance pricing. The advantage of this approach is that it will force insurance companies to compete over controlling costs instead of avoiding risks -- to the ultimate benefit of consumers. It would be opposed by the insurance industry.

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[1] By imposing a specific standard catastrophic cost package that would qualify for the option, the federal government would encourage strong price competition for that package.

[2] However, this process could be expedited by allowing the current tax exemption for employment-based insurance premiums to be applied only (or more advantageously) to the catastrophic cost package. The justification would be that the purpose of the favorable tax treatment of insurance premiums is to encourage people to be insured against catastrophic costs so that they do not lose their assets and require state assistance.

**Argument**

Normally, consumers do not choose to purchase insurance for all eventualities. Routine events, events that are regularly scheduled and easily priced, are not insured against. It costs the consumer less to pay for them directly. For that reason, no one buys car insurance to cover car maintenance, such as oil changes and new tires. Consumers do, however, seek insurance against catastrophic events: low probability events that cost a great deal of money. For that reason, people with assets generally seek to buy collision insurance for cars even without tax incentives.

The health insurance market differs from the car insurance market because health insurance is granted preferential tax treatment. The system of tax subsidies for health insurance has encouraged employers to offer insurance for activity that consumers do not usually insure against. We do not, however, distinguish between "maintenance" insurance and catastrophic insurance. Catastrophic care insurance -- or major medical, as it is often called -- is "real" insurance. People buy "maintenance" health insurance today primarily to shelter income from taxes.

Health insurance premiums are excluded from taxable income because we want people to plan for these risks themselves. As an original matter, we might have limited the tax benefit to "real" insurance only. Unfortunately, people are now used to the current system. A tax cap will be seen by people who now have generous "maintenance" insurance plans as a tax increase. In my judgement, a tax increase on the 85 percent of the people who have insurance to pay for new tax credits for the 15 percent who do not now have insurance is a political loser.

I believe avoiding costly state health mandates and changing the structure of the insurance market will address the anxiety about health care that is at the root of the perceived "health crisis" better than a tax increase and credit plan. The changes discussed below will drive consumers toward lower-cost "real" insurance plans without making any significant changes to the tax code. Lowering the cost of health care through deregulation and increasing access by applying common-carrier type rules to insurance companies will also help the 30 million who are now uninsured.

While the structure of the tax system has encouraged the vast majority of employers to offer health insurance to their employees, it has the unfortunate consequence of making it difficult to purchase individual policies. In particular, it has led insurance companies to adopt a system of rating risks -- and pricing policies -- for each employer separately. The bigger the employer, the lower the price (generally speaking) because risk is lowered by greater diversification across many people.

One significant benefit of employer-based rating is employers who engage in risky activity can be charged a higher rate. This is good for the economy because it encourages high risk employers to take steps to prevent accidents and it incorporates the full cost of production into the price of the product.

One drawback is that it creates an incentive for insurance companies to try to avoid random catastrophic risks, like brain tumors. These events occur with some frequency that is often outside the control of the insured and that are spread more or less evenly across the population. Under current law, there is no distinction between risk rating and ex-post bad event rating -- companies can cancel policies or jack-up rates after a low probability but high cost insurable event occurs. Many people who would like to be insured but have a health problem, such as many individuals with epilepsy, are either deemed uninsurable by insurers, or offered policies with such high premiums or so many exclusions and conditions that they are practically worthless.[3]

The alternative to employer-based rating is community rating or some other "one price" rule similar to that I advocate below. A "one-price" rule forces the insurer to assess risks across the entire portfolio of risks it insures. Rather than ask employees to subsidize each other, all customers of the insurance company subsidize each other. This approach trades the benefit of efficient pricing of insurance in exchange for extending coverage, but may be the preferable approach to the problem. First, it forces insurance companies to cross subsidize risks instead of the government, as some now propose. Second, there are other ways than insurance prices we encourage employers to reduce risks, such as OSHA regulations and litigation risks.

An insurance reform proposal would also be easier to explain to the American people. It could be described by declaring our intent to outlaw discrimination and unfair practices by insurance companies. This puts us in the populist position of fighting the big ol' insurance companies for the little guy.

The likely result of implementing these reforms would be to encourage consolidation within the insurance industry and, perhaps, integration with health service providers. I believe this would be the likely result of outlawing competition to avoid risks, because the biggest profit opportunity would now come from controlling costs when an insurable event happens. Even if full

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[3] Department of Justice regulations for title III of the Americans with Disabilities Act mandate that any differential treatment by insurers be justified by sound actuarial data. Consequently, insurers may still treat high-risk individuals adversely if they find some actuarial basis for doing so.

integration does not result, preferred provider arrangements would probably spread under this system. This type of integration would harness the private sector profit motive in the mission of cost control; a mission the private sector is likely to perform better than the government.

It should be noted that the rapidly rising cost of health insurance is also a political problem. There are numerous reasons for this problem.[4] One reason relates to state laws that require insurers to cover certain specified services in their policies.[5] Almost all states now have such "mandated benefits laws," and it has been estimated that they increase premiums by approximately seven percent. These laws typically result from heavy lobbying by strong provider groups to require coverage of their services. It is questionable whether consumers would be willing to pay the marginal premium for coverage of many of these services if given a choice, particularly since they do not tend to be the type of benefits for which insurance is primarily intended.

**Conclusions**

Under this proposal, the number of people with adequate health insurance coverage could be increased substantially with no increase in federal or state taxes or other revenues. Due to the option to choose a catastrophic care plan instead of a plan with state mandated benefits, it would encourage the type of catastrophic health insurance coverage that is most needed by the population.[6] Due to community rating, risks would be spread over a large population, and people at high risk of health problems would be brought into the overall pool.

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[4] Perhaps most significant is that purchasers of health insurance and health care services have little incentive to contain costs. Employer contributions to employee health insurance plans are currently not taxable, reducing the incentive for employers and employees to shop carefully. Consequently, there is little price competition among insurers, HMOs and other health plans. Nothing in the system substantially promotes the cost-conscious use of resources or the efficient provision of services.

[5] Other considerations contributing to health care inflation include the ability of physicians to generate their own demand for services, and the high costs associated with medical technology, malpractice litigation, and the aging of the population.

[6] The proposal could be enhanced further by limiting the current tax exemption for employment-based premiums only to the catastrophic coverage option, thereby further encouraging such coverage and enhancing the cost consciousness of consumers.

# DRAFT

**A No-Tax Proposal to Contain Costs and Enhance Access to Private Sector Health Insurance**

It is widely believed that this country is approaching a health insurance crisis. While 85 percent of the population currently has health care coverage, many people are concerned that they are not insured adequately for a catastrophic illness or injury. Many are worried that if they lose their job they will join the 30 million people who have no health insurance at all. Others are concerned that their insurance rates will skyrocket if they get sick -- just as the rates for the RNC grew astronomically after Lee Atwater developed a serious illness.

Recent polls reflect these twin concerns: Am I <u>really</u> insured if I get sick? What happens if I lose my job and then get sick? This paper presents a proposal to address these concerns without imposing new taxes or otherwise having to raise additional revenues.

The proposal has two components.

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   - o insure anyone who requests insurance; and
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1. <u>Enhance consumer choice by allowing insurers to offer a basic high-deductible federally-approved catastrophic care policy instead of the state-regulated insurance policies that include mandated benefits.</u>

Consumers should have the choice to avoid the cost of state mandated benefits by allowing insurers and employers to offer a standard catastrophic health care policy with a high deductible. Federal preemptory legislation would be needed to implement this approach. Rather than define a complex package of covered services, it might specify that the cost of all health care services (defined broadly) beyond $2,000 per year are covered and

would be paid by the insurer.[1] It is expected that, over time, insurers will choose to offer the presumably less expensive catastrophic care package, and policies with mandated benefits will become more expensive and eventually wither away.[2]

This should reduce the cost of health insurance premiums by eliminating unwanted mandated benefits while offering the type of catastrophic care coverage that is truly needed. It would thereby enhance access and reduce the anxiety of citizens that they will not be insured for a catastrophic event. A major drawback is that it would involve some preemption of state insurance regulation, raising federalism concerns.

2. Treat all health insurers, including HMOs and PPOs, like common carriers. That is, require insurers to:
   - o insure anyone who requests insurance; and
   - o charge all applicants the same price, while allowing discounts to discourage risky behavior.

This would require all insurers to act like a common carrier, taking all customers at one price. Insurers could offer discounts from that price to create incentives for consumers to avoid risky behavior, such as smoking, and to engage in risk-reducing behavior, such as prenatal care.

This would enhance access to health insurance for people at high risk of health problems without raising additional taxes. Rather than have the government cross-subsidize risks through the tax code, as the Heritage Foundation and others propose, consumers would cross-subsidize risks through insurance premiums. In so doing, the catastrophic care package would cost more than it otherwise would for low-risk consumers, but it is still likely to cost less and provide better overall coverage than the current mandated benefit packages that states now require.

The disadvantage of this proposal is that it would reduce the efficiency of insurance pricing. The advantage of this approach is that it will force insurance companies to compete over controlling costs instead of avoiding risks -- to the

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ultimate benefit of consumers. It would be opposed by the insurance industry.

**Argument**

Normally, consumers do not choose to purchase insurance for all eventualities. Routine events -- events that are regularly scheduled and easily priced -- are typically not insured against. Due to the administrative costs of covering such events, it costs the consumer less to pay for them directly. For that reason, there is no market for car insurance to cover routine car maintenance, such as oil changes and new tires. Consumers do, however, seek insurance against catastrophic events: low probability events that cost a lot of money. For that reason, people with assets generally seek to buy collision insurance for cars even without tax incentives.

The health insurance market differs from the car insurance market in large part because health insurance is granted preferential tax treatment. The system of tax subsidies for health insurance has encouraged employers, under pressure from unions, to offer insurance for events that consumers do not usually insure against. In this paper, I distinguish between "maintenance" insurance, which consumers typically do not purchase, and catastrophic insurance, which they typically purchase. Catastrophic care insurance -- or major medical, as it is often called -- is "real" insurance. People buy "maintenance" health insurance today primarily due to the tax subsidy.

Historically, health insurance premiums were excluded from taxable income because we wanted people to plan for these risks themselves. As an original matter, we might have limited the tax benefit to "real" insurance only.[3] Unfortunately, employers, unions, insurers and employees are now accustomed to the current system. A tax cap will be seen by people who now have generous "maintenance" insurance plans as a tax increase. In my judgment, a tax increase to pay for new tax credits for the 15 percent who do not now have insurance is a political loser.

It should be noted that the rapidly rising cost of health insurance is also a political problem. There are numerous

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[3] In addition, we might have used a refundable tax credit rather than an exclusion. The exclusion is particularly inequitable, because it provides the greatest insurance subsidy to people in the highest tax bracket -- presumably the people who need it least.

reasons for health care inflation.[4] One reason relates to state laws that require insurers to cover specified services in their policies.[5] Almost all states now have such "mandated benefits laws," and it is estimated that they increase premiums by over seven percent. These laws typically result from heavy lobbying by strong provider groups to require coverage of their services. It is questionable whether consumers would be willing to pay the marginal premium for coverage of many of these services if given a choice, particularly since they do not tend to be the type of benefits for which insurance is primarily intended.

I believe that avoiding costly state health benefit mandates and changing the structure of the health insurance market will address the anxiety that is at the root of the perceived "health crisis" better than a tax increase and credit plan, as proposed by some. The proposal to allow insurers to offer a standard catastrophic care policy instead of a policy with state mandated benefits will drive consumers toward lower-cost "real" insurance plans without making any significant changes to the tax code. Lowering the cost of health care through deregulation and increasing access by applying common-carrier type rules to insurers will also help the 30 million who are now uninsured.

While the structure of the tax system has encouraged the vast majority of employers to offer health insurance to their employees, it has the unfortunate consequence of making it difficult to purchase individual policies. In particular, it has led insurers to adopt a system of rating risks, and pricing policies, for each employer separately. Generally speaking, the bigger the employer, the lower the price because overall risk is lowered by greater diversification across many people. One benefit of employer-based rating is employers who engage in risky activity can be charged higher rates.[6]

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[4] Perhaps most significant is that purchasers of health insurance and health care services have little incentive to contain costs. Employer contributions to employee health insurance plans are currently not taxable, reducing the incentive for employers and employees to shop carefully. Consequently, there is little price competition among insurers, HMOs and other health plans. Nothing in the system substantially promotes the cost-conscious use of resources or the efficient provision of services.

[5] Other considerations contributing to health care inflation include the ability of physicians to generate their own demand for services, and the high costs associated with medical technology, malpractice litigation, and the aging of the population.

[6] This is good for the economy because it encourages high risk employers to take steps to prevent accidents and it incorporates the full cost of production into the price of the

control; a mission the private sector would perform better than the government.

## Conclusions

Under this proposal, the number of people with adequate health insurance coverage could be increased substantially with no increase in federal or state taxes or other revenues. Due to the option to choose a catastrophic care plan instead of a plan with state mandated benefits, it would encourage the type of catastrophic health insurance coverage that is most needed by the population.[9] Due to community rating, risks would be spread over a large population, and people at high risk of health problems would be brought into the overall pool.

[9] The proposal could be enhanced further by limiting the current tax exemption for employment-based premiums only (or preferably) to the catastrophic coverage option, thereby further encouraging such coverage and enhancing the cost consciousness of consumers.

A significant drawback of employer-based rating is that it creates an incentive for insurance companies to try to avoid certain catastrophic risks, like brain tumors,[7] through policies that allow them to eliminate enrollees with such problems once they have occurred. Under current law, there is no distinction between risk rating and ex-post bad event rating -- insurers can cancel policies or jack-up rates after a low probability/high cost insurable event occurs. Many people who would like to be insured but have a health problem, such as individuals with epilepsy, are either deemed uninsurable by insurers, or offered policies with very high premiums or so many exclusions and conditions that they are practically worthless.[8]

The alternative to employer-based rating is community rating or some other "one price" rule. This would force the insurer to assess risks across the entire portfolio of risks it insures. Rather than ask employees to subsidize each other, cross-subsidization would occur across all customers of the insurer. This approach trades efficient insurance pricing for extension of coverage, and is preferable to cross-subsidization by the government with its adverse budgetary implications. Moreover, an insurance reform proposal would be easier to explain to the American people. It could be described by declaring our intent to outlaw discrimination and unfair practices by insurers. This puts us in the populist position of fighting the big insurance companies for the little guy.

The likely result of implementing these reforms would be to encourage consolidation within the insurance industry and, perhaps, greater integration with health service providers. I believe this would be the likely result of outlawing the ability of insurers to avoid bad risks, because the biggest profit opportunity would now come from controlling costs when an insurable event happens. Even if full integration, in the form of HMOs and similar organizations, does not result, preferred provider arrangements and other efficient joint ventures would probably spread under this system. Such integration would harness the private sector profit motive in the mission of cost

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product.

[7] These events occur with some frequency that is often outside the control of the insured, and are spread more or less evenly across the population.

[8] Department of Justice regulations for title III of the Americans with Disabilities Act mandate that any differential treatment by insurers be justified by sound actuarial data. Consequently, insurers may still treat high-risk individuals adversely if they find some actuarial basis for doing so.

THE WHITE HOUSE
WASHINGTON

**Date:** 9-10-91

**TO:** Hanns Kuttner

**FROM:** **RICHARD W. PORTER**
**Special Assistant to the President and Executive Secretary to the Domestic Policy Council**

Hanns,

Could you take a look at this and offer your comments? Thanks.

## Health Insurance in the Private Sector:
## Options to Contain Costs While Enhancing Access

It is widely believed that this country is rapidly approaching a health insurance crisis. While 85 percent of the population currently has health care coverage, many people are not insured adequately for a catastrophic illness or injury. Many are worried about joining the 30 million people who have no health insurance at all. Recent polls demonstrate widespread concern among Americans over their ability to obtain adequate, affordable health insurance. Their anxiety relates to two closely associated concerns: 1) maintaining access to adequate health care coverage, and 2) paying the escalating costs of such coverage (and of health care services generally). We are currently spending 13 percent of our GNP on health care, a higher percentage than any other industrialized country, and we are not getting adequate value for our enormous health care expenditure.

### The Problems

With respect to poor access, many people who do not work for employers that offer health insurance and who are not eligible for Medicare, Medicaid, VA or other public health benefits cannot afford to pay for individual policies. Similarly, many

employers, particularly marginal small businesses, cannot afford to pay for insurance for their employees. In large part, resolving the problem of access would require substantial resources to subsidize the coverage of those who cannot afford it. Such resources would have to derive from the private sector, the public sector, or a combination of both, and these sources have been tapped largely to their limits. Whether or not the Administration chooses to subsidize coverage, it could enhance access by reducing the cost of insurance to make it more affordable for everyone.[1]

With respect to rising costs, the problem has several sources. Perhaps most significant is that purchasers of health insurance and health care services have little incentive to contain costs. Employer contributions to employee health insurance plans are currently not taxable, reducing the incentive for employers and employees to shop carefully for health insurance and health care services. Consequently, there is little price competition among insurers, HMOs and other health plans. Nothing in the system substantially promotes the cost-conscious use of resources or the efficient provision of services. Regulation has proven ineffective in containing costs

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[1] One way that this can be achieved is through insurance purchasing organizations, discussed below, which allow individuals to join together to spread their risks and administrative costs. Another way is to reduce the underlying costs of health care, possibly through malpractice reform and through utilization review.

and tends to lock in inefficiencies.[2]

An Administration initiative to address these problems should ideally:

- reduce the anxiety of citizens over whether they will be insured for a catastrophic event or whether they will lose their health insurance;

- enhance access to health insurance through an equitable financing mechanism;

- contain health care costs by enhancing efficiency (through price competition) without imposing an undue burden on high-cost individuals;

- be implemented without the need for a substantial bureaucratic apparatus;

- be budget neutral and not require new taxes or an increase in the tax burden on the average citizen; and

- not impose an increased burden on employers,

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[2] Other considerations contributing to health care inflation include the ability of physicians to generate their own demand for services, and the high costs associated with medical technology, malpractice litigation, and the aging of the population.

particularly marginal small businesses.

The problem of poor access to health insurance will be ameliorated to some extent by containing health care costs generally, thereby making insurance more affordable for everyone. Moreover, if there are not effective mechanisms for cost containment in an initiative to enhance access, the result will be even higher rates of health care inflation and ultimately poorer access to insurance. For these reasons and for analytical clarity, this paper addresses options to contain costs separately from options to enhance access, with cost containment options presented first. However, it should be recognized that many of the cost containment and access enhancement options are complementary, and an Administration initiative could include a package of several compatible options.

## Options to Contain Costs

1. Make employer premium contributions taxable to employees beyond some level.

Under the Internal Revenue Code, an employer's health insurance premium contributions are not taxable to employees. Thus, employees pay for such premiums with pre-tax dollars, which reduces their cost consciousness in shopping for health coverage.

Consequently, the incentive for employers to structure their insurance options to encourage the use of more cost-effective plans is attenuated, and few employers do so rigorously. In turn, insurers that are not pressured to contain their costs typically have open-ended fee-based reimbursement systems that do not induce providers to contain their costs. Thus, the favorable tax treatment of insurance premiums is largely driving the lack of cost consciousness throughout the health care system.

Moreover, the current exclusion of employer-based premiums is inequitable, in that taxpayers in the highest income brackets who presumably have the least need for subsidization receive the highest subsidy. People with incomes so low that they have no tax liability receive no subsidy. This option would require a modification of the Internal Revenue Code to limit or eliminate the tax exclusion for premium contributions. Alternatives within this option could include taxing the employee for the total employer premium, exclusion of a portion of the employer premium, or exclusion of a portion of the employer premium used to purchase specific coverage that the federal government wishes to encourage (e.g., coverage for catastrophic costs).

Pros

- would substantially enhance the cost consciousness of employees and employers, thereby inducing them to shop

carefully for more efficient and less costly health care plans and providers.

- would enhance the equity of the financing system.

- would raise additional tax revenues (that could be used to subsidize insurance) without creating a new tax.

Cons

- would impose an additional tax burden on employees and could be perceived by some as a new tax.

2. Encourage the development of insurance purchasing organizations to enhance risk pooling and reduce administrative costs.

Many small businesses are not able to purchase affordable health insurance because the number of their employees is too small to adequately spread health risks and administrative costs. Similarly, individuals who are not covered through a large employer or other group often are not able to purchase affordable policies. Insurance purchasing organizations are state or local-based agencies that offer an array of health insurance plans to members of their communities, thereby spreading risks and

administrative costs over a larger population, reducing premiums and permitting a broader array of benefits. By containing costs, this option would also significantly enhance access for individuals and small businesses.

Similar to the Federal Employees Health Benefits Plan, each insurance purchasing organization could offer a set of competing health plans (such as HMOs, PPOs, and traditional indemnity plans) from which its community members may choose. The federal government could encourage the establishment of such organizations by providing seed money to the states on the condition that certain rules are followed by each organization. For example, an insurance purchasing organization could be required to accept all applicants for the same premium.

Pros

- would spread health risks and administrative costs over a larger population, thereby reducing the cost of coverage and enhancing access for small businesses and individuals.

Cons

- would require a mechanism to prevent "adverse selection," in which only the highest risk individuals

and businesses would be attracted to the insurance purchasing organizations, thereby increasing premiums.

3. Encourage price competition through managed competition among health care plans.

For a variety of reasons such as adverse selection, preferred risk selection, inadequate information and product differentiation, the markets for health insurance and health care services are not inherently competitive. To correct these market imperfections, specific rules may be applied to create a system of "managed competition." For example, there is a strong incentive for a competing health insurance plan to encourage low-cost individuals to enroll, thereby keeping its premiums low. Consequently, rules are needed to prevent insurers from discriminating against high-risk individuals. Similarly, most purchasers of health insurance are not able to compare competing plans with vastly different benefit packages, and a standard benefit package would be helpful to make sound decisions based on price and quality.

The federal government could use the leverage of its current tax subsidy for employment-based health plans to encourage managed competition. For example, it could make the tax subsidy available only for federally-approved plans that meet the

requirements for a system of managed competition. Similarly, if the federal government provides seed money for insurance purchasing organizations (see option 2 above), it could require that the plans offered by each such organization must conform to the requirements of a managed competition system. The insurance purchasing organizations would then actively attempt to encourage competition within its markets.

Pros

- would induce greater efficiency in the health care market and yield substantial long-term savings.

Cons

- would require a bureaucratic apparatus for administration and enforcement of the rules of managed competition.

4. Create a choice for insurers to bypass state mandated benefits laws if they offer a standard federally-approved catastrophic cost policy.

Almost all states now have mandated benefits laws that

require insurers to cover certain specified services in their policies. These laws typically result from heavy lobbying by strong provider groups to require coverage of their services. It is questionable whether consumers would be willing to pay the marginal premium for coverage of many of these services if given a choice, particularly since they do not tend to be the type of benefits for which insurance is primarily intended. The primary purpose of insurance is to spread the risks of a financially catastrophic event over a large population, not to serve as a payer of relatively inexpensive and/or certain events that could be paid out-of-pocket without incurring the administrative costs of an insurer.

Under this option, insurers would have the choice to avoid coverage of state mandated benefits by offering a standard policy that protects enrollees for all covered catastrophic health care costs beyond a set level. Federal preemptory legislation would be needed to implement this approach. Such legislation could specify all health care services whose costs would qualify toward a specified catastrophic threshold amount. Beyond the threshold, the cost of all these covered services would be paid. By imposing a specific standard catastrophic cost package that would qualify for the option, the federal government would encourage strong price competition for that package. It is expected that, over time, insurers will choose to offer the (presumably less expensive) catastrophic cost package, and policies with mandated

benefits will wither away.[3]

Pros

- would reduce the anxiety of citizens that they will not be insured for a catastrophic event;
- would enhance access to health insurance.
- would reduce the cost of premiums while offering the type of coverage that is truly needed.

Cons

- would require federal preemptory legislation which may raise objections concerning federalism.
- would still require some bureaucratic apparatus to define and enforce the standard benefit package.

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[3] However, this process could be expedited by allowing the tax exemption for employment-based insurance premiums to be applied only (or more advantageously) to the catastrophic cost package. The justification would be that the purpose of the favorable tax treatment of insurance premiums is to encourage people to be insured against catastrophic costs so that they do not lose their assets and require state assistance.

5. Create a free market for health insurance and subsidize people who pay higher than average premiums with refundable tax credits.

This option, which is advocated by the Heritage Foundation, would allow health insurance premiums to rise to the market level for all people, irrespective of their health status. It would then subsidize people with higher than average premiums with a refundable tax credit. This approach is theoretically attractive, in that it induces efficiency in the insurance market, and addresses the issues of equity/income redistribution separately. However, it has several practical problems. From a budget perspective, it will cost the federal government large amounts of money to subsidize the coverage of high cost people. From a political perspective, it will be opposed strongly by disability groups concerned that the amount of the subsidies will diminish over time in response to budgetary pressures. Finally, by subsidizing higher than average premiums, this option is likely to induce cost inflation unless it includes a substantial cost containment element.

Pros

- would (at least theoretically) induce the efficient

provision of health insurance, since free market prices would create no incentive for adverse selection or preferred risk selection.

Cons

- would be opposed politically by high-risk groups due to the concern that their subsidy will diminish to an inadequate level over time.

- would require new taxes or a substantial reduction in other expenditures to be budget neutral.

6. Require all employers either to provide a standard package of benefits to their full-time employees or to pay a payroll tax which would pay for their premiums.

This "play or pay" financing mechanism to subsidize coverage is the most controversial aspect of the Mitchell bill, the predominant Democratic health care reform proposal. It has already been rejected by the President due to its likely effect on the economy, and is presented here solely for the purpose of comparison with the other options. In an attempt to soften the impact of "play or pay," the Mitchell bill provides for a phase-in for most businesses, a two year exemption for new small

businesses, a 100 percent tax deduction for all businesses, and a 25 percent tax credit for "low profit" small businesses. Still, the idea of mandating insurance coverage is unacceptable to much of the business community. It is likely to create a substantial hardship for many small businesses.

Pros

- would provide the funds to cover large segments of the uninsured population.

Cons

- would require a new tax that would impose a substantial additional burden on business.
- would require a substantial reduction in other expenditures to be budget neutral.
- would require substantial bureaucratic oversight to ensure compliance with the "play or pay" requirement.

7. Encourage all employers to provide a standard package of catastrophic care benefits.

An alternative to "play or pay" would be to induce eligible small businesses to offer health insurance voluntarily by offering them a very substantial tax credit (i.e., 50 to 75 percent of the premium). To achieve budget neutrality, this credit would have to be offset by an increase in revenues. The most attractive approach to raising such revenue would be to make employer contributions taxable to employees beyond some level (see option 1 under cost containment), thereby increasing the cost-consciousness of employers.[4]

Pros

- would enhance access to health insurance for employees of small businesses.

Cons

- would require a substantial increase in revenues or reduction in expenditures, and possibly a new tax, to pay for the tax credit.

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[4] Assuming this approach is insufficient to raise the necessary revenues, one possibility would be to impose a tax on health care providers. While any new taxes should be avoided to the full extent possible, the relative advantage of a tax on providers is that they would be primary financial beneficiaries of the expanded coverage, and such a tax could have the advantage of inducing additional cost-consciousness by payors and providers.

8. Treat all health insurers, including HMOs and PPOs, as common carriers that must accept all applicants for a set premium.

Currently, health insurers are free to discriminate against people at high risk of health problems, except to the extent prohibited by a few state laws. Many people who would like to be insured but have a health problem, such as many individuals with epilepsy, are either deemed uninsurable by insurers, or offered policies with such high premiums that they are virtually unaffordable or policies with so many exclusions, limitations, and pre-existing conditions clauses that they are practically worthless. Department of Justice regulations for title III of the Americans with Disabilities Act mandate that any differential treatment by insurers be justified by sound actuarial data. Consequently, insurers may still treat high-risk individuals adversely if they find some actuarial basis for doing so.

This option would require all insurers to serve as common carriers and treat all applicants similarly with respect to premiums charged. Mechanisms would be needed to prevent insurers from engaging in preferred risk selection, such as developing benefit packages that cater particularly to the needs of healthy individuals and not covering services particularly needed by people with health problems.

Pros

- would enhance access to health insurance for people at high risk of health problems.

Cons

- would require bureaucratic apparatus for administration and enforcement of the community rating and the rules against risk selection.

- would be opposed politically by the health insurance industry as an attempt to limit their ability to assess and underwrite risks.

## Conclusions

Analysis of the above options suggest that options 1, 2, 3, 4, and 8 may be politically and economically feasible, and should be considered seriously. In addition, there are several option packages that could serve as an Administration health insurance initiative. They are as follow:

1. Options 1 & 2

Pros

- would enhance access to health insurance for people at high risk of health problems.

Cons

- would require bureaucratic apparatus for administration and enforcement of the community rating and the rules against risk selection.

- would be opposed politically by the health insurance industry as an attempt to limit their ability to assess and underwrite risks.

## Conclusions

Analysis of the above options suggest that options 1, 2, 3, 4, and 8 may be politically and economically feasible, and should be considered seriously. In addition, there are several option packages that could serve as an Administration health insurance initiative. They are as follow:

1. Options 1 & 2

Under this package, the federal government would encourage the establishment of insurance purchasing organizations to reduce costs and enhance access for individuals and small businesses, and would reduce the tax exemption for employment-based insurance premiums to enhance the cost consciousness of purchasers of health insurance.

2. Options 1, 2 & 3

This package would be similar to package 1 directly above except that the insurance purchasing organizations would have a more active role in managing a competitive system. In addition, employers that offer insurance for their employees would be encouraged to manage a more competitive system.

3. Options 1, 2 & 4

This package would be similar to package 1 except that the insurance purchasing organizations and employers would have the choice to offer catastrophic cost plans as an alternative to plans with state mandated benefits.

4. Options 1, 2, 3 & 4

This package would be similar to package 1 except that the insurance purchasing organizations and employers would have the

choice to offer catastrophic cost plans as an alternative to plans requiring state mandated benefits, and would actively manage competition among such plans.

5. Any of the above packages in conjunction with option 8

By adding option 8 to any of these packages, the number of people with health insurance coverage could be increased. Due to community rating, risks would be spread over a large population, and people at high risk of health problems would be brought into the overall pool.