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The Uncertainty of Health Care Projections

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The Patient and Protection and Affordable Care Act (PPACA) is one of the largest and most controversial pieces of legislation ever enacted. Many economists and policy analysts have very different views on what effect PPACA will have on business, government finances, and the health care industry. During the debate, the Congressional Budget Office (CBO) had the daunting task of issuing the official estimate of the bill's costs and savings. In announcing its findings, CBO director Douglas Elmendorf emphasized the uncertainty of the estimates.

This calculator focuses on the idea that the CBO could be wrong in its estimates. Many economists from the Left and the Right, from academia and the private sector, have prepared their own estimates of the bill's impact. Consequently, this calculator allows users to examine various scenarios using estimates from opposite ends of the ideological spectrum. For example, if a user believes that both David Cutler's estimate of administrative savings and Douglas Holtz-Eakin's estimate of the impact on employer-sponsored insurance are correct, then the user could make a calculation that uses both estimates. Indeed, there are seven different questions that can be answered by the user that reflect either contrasting studies by respected analysts or the likelihood that certain provisions of PPACA will be enacted.[1]

The Individual Mandate.[2] PPACA requires that almost all individuals acquire health insurance through an employer, an individual plan, an insurance exchange, or Medicaid. Most individuals who fail to get coverage will be subject to a tax penalty. Without the mandate, the number of uninsured individuals will be higher.

The individual mandate continues to be a focal point of the health care debate because of concerns over the provision's constitutionality. Many legal experts argue that forcing individuals to purchase a good or service is unprecedented and unconstitutional.

The CBO acknowledged the exceptionality of the mandate when it concluded that requiring all draft-age men to enlist in the Selective Service is the closest legal requirement to the individual mandate. Virginia was one of the first states to fight back on the provision after passing its own statute protecting its citizens from complying with the mandate on the grounds that it is unconstitutional and represents an erosion of individual liberty. In addition, 19 other states, along with the National Federation of Independent Business, have joined forces to file federal lawsuits against the mandate. Furthermore, public polling has shown that the individual mandate is one of the most unpopular components of the health care law.

Medicare Cuts.[3] CBO projects that PPACA will cut Medicare costs, on net, by about $455 billion between 2010 and 2019. However, these cuts are uncertain for two key reasons:

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1. The cuts are politically unpopular and may be rescinded;
2. The proposed cuts to health care providers could negatively impact access and quality of care to such a degree that changes would have to be made.

CBO has stated, "It is unclear whether such a reduction in the growth rate of spending could be achieved, and if so, whether it would be accomplished through greater efficiencies in the delivery of health care or through reductions in access and quality of care." Furthermore, the Office of the Actuary at the Center for Medicare and Medicaid Services has stated that "the estimated savings shown…may be unrealistic.… Providers for whom Medicare constitutes a substantive portion of their businesses could find it difficult to remain profitable and, absent legislative intervention, might end their participation in the program."

The likelihood of future Medicare cuts was also questioned in the recent report by the Medicare trustees, a board that includes Secretaries of the Treasury, Health and Human Services, and Labor. Certainly a future Congress would be inclined to prevent such cuts. Furthermore, actual Medicare cost growth per beneficiary was below the target level in only four of the last 25 years.

Drop in Employer Sponsored Insurance.[4] Employer-sponsored insurance is the largest source of health insurance today and (pre-PPACA) was projected to cover 163 million workers in 2019. PPACA disrupts health care markets by creating state insurance exchanges and establishing subsidies in ways that will propel people out of employer-sponsored plans and into the exchanges or Medicaid.

Many employers will analyze the costs and benefits for continuing to offer health insurance coverage to their employees. Employers with more than 50 workers face a $2,000 fine per employee for dropping coverage (employers with less than 50 workers do not face a fine), yet offering family health insurance coverage costs about six times that much. Since many employees who are dropped would be able to obtain generous subsidies to purchase coverage in the exchanges, many employers and employees will find it mutually advantageous to drop coverage. This would happen because employers would pass on some of the savings to employees in the form of higher wages.

For example, if a large firm is contributing $10,000 a year to an employee's health insurance, it would save $8,000 ($10,000 minus the $2,000 fine) a year for dropping that worker's coverage. If the worker qualifies for a $6,000 subsidy to purchase a $10,000 insurance plan, the worker would be worse off by $4,000 from when the employer paid for health insurance. However, since the employer gained a greater amount from dropping employer-sponsored insurance than the worker lost, there is room for a mutually beneficial trade.

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1. Please note that due to the fact that some of the figures used represent a combination of data from various scenarios, citations will be provided by section.
2. Congressional Budget Office, "CBO Memorandum: The Budgetary Treatment of an Individual Mandate to Buy Health Insurance," at *http://www.cbo.gov/ftpdocs/48xx/doc4816/doc38.pdf* (July 19, 2010); Dan Danner, "ObamaCare vs. Small Business," *The Wall Street Journal*, May 27, 2010, at *http://online.wsj.com/article/SB10001424052748704113504575264802756326086.html* (July 19, 2010); Kaiser Family Foundation, "Kaiser Heath Tracking Poll: Public Opinion on Health Care Issues," June 2010, at *http://www.kff.org/kaiserpolls/upload/8082-F.pdf* (July 19, 2010); and Rosalind S. Helderman, "Virginia Senate Bills Say No to Requiring Health Insurance," *The Washington Post*, February 2, 2010, at *http://www.washingtonpost.com/wp-dyn/content/article/2010/02/01/AR2010020103674.html* (July 19, 2010).
3. Douglas W. Elmendorf, Director, Congressional Budget Office, "Letter to the Honorable Nancy Pelosi, Speaker, U.S. House of Representatives," March 20, 2010, at *http://www.cbo.gov/ftpdocs/113xx/doc11379/AmendReconProp.pdf* (June 22, 2010); Richard Foster, "Estimated Financial Effects of the 'Patient Protection and Affordable Care Act,' as Amended," U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services, April 22, 2010, at *https://www.cms.gov/ActuarialStudies/Downloads/PPACA_2010-04-22.pdf* (June 30, 2010).
4. Douglas W. Elmendorf, Director, Congressional Budget Office, "Letter to the Honorable Nancy Pelosi, Speaker, U.S. House of Representatives"; Douglas Holtz-Eakin and Cameron Smith, "Labor Markets and Health Care Reform: New Results," American Action Forum, May 2010, at *http://americanactionforum.org/files /LaborMktsHCRAAF5-27-10.pdf* (July 6, 2010).

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Furthermore, in order to attract quality workers, the firm would have to raise wages by at least $4,000. If the employer increases the worker's wages by $6,000, then both the firm and the worker are better off by around $2,000 (there would be some tax implications) relative to pre-PPACA law.

The incentive will be even greater for small firms to drop employees' coverage because they do not face the $2,000 fine. And since relatively low-wage employees will receive more generous subsidies, low-wage employees are the most likely to be dropped.

Former CBO director Douglas Holtz-Eakin found that employees who make less than 2.5 times the federal poverty level (or just over $55,000 in 2010 for a family of four) will face an economic incentive to drop coverage. Holtz-Eakin argues that as many as 43 million people covered by employer-sponsored insurance may lose their current coverage after facing the mutual incentive to drop. On the other hand, CBO estimates that 8–9 million people "who would be covered by an employment-based plan under current law would not have an offer of such coverage under the proposal."

The Tax on High-Cost, "Cadillac" Health Plans.[5] PPACA includes an excise tax on expensive (or "Cadillac") health insurance policies. The provision levies a 40 percent non-deductible tax on the annual value of health plans that cost more than $10,200 for single coverage or $27,500 for family coverage. The IRS will begin collection in 2018, increasing the limit by the rate of inflation every year thereafter.

The reason the Cadillac tax was included was to encourage employees to buy and employers to provide less expensive health plans. The tax was pushed back four years to a 2018 start date primarily because of union objections.

Taxes on Medical Devices, Hospitals, and the Health Care Industry.[6] PPACA imposes a 2.3 percent excise tax on medical devices (such as powered wheelchairs, hearing aids, breast-milk pumps, prosthetics, replacement joints, and diagnostic tools like MRI and CT scanners) as well as additional annual fees on health insurance providers. These fees are set to increase incrementally each year.

Common economic theory explains that the burden of any tax is likely to be shared between the supplier and consumer. A tax placed on suppliers (insurance companies and medical device companies) will likely be passed down on consumers (patients) in the form of higher premiums.

Health Information Technology.[7] In a complex health care system, generating and processing information between insurance companies, hospitals, physicians, and patients is a challenging task. By adopting more sophisticated approaches to managing information such as electronic health records, health care information technology aims to increase efficiency in the health care sector and improve the quality of care delivered to patients.

Both PPACA and the stimulus bill make large federal investments with the intention of improving health IT. Some experts believe that improved health care IT can place downward pressure on the health care cost curve. Others, however, contend

5. Douglas W. Elmendorf, Director, Congressional Budget Office, "Letter to the Honorable Nancy Pelosi, Speaker, U.S. House of Representatives"; Patient Protection and Affordable Care Act of 2010, Public Law 111-148.
6. Joint Committee on Taxation, "Estimated Revenue Effects of the Manager's Amendment to the Revenue Provisions Contained in the 'Patient Protection and Affordable Care Act,'" December 19, 2009, at *http://www.jct.gov/publications.html?func=select&id=17* (August 27, 2010).
7. Douglas W. Elmendorf, Director, Congressional Budget Office, "Letter to the Honorable Evan Bayh, Speaker, U.S. Senate," November 30, 2009, at *http://www.cbo.gov/ftpdocs/107xx/doc10781/11-30-Premiums.pdf* (June 22, 2010); David M. Cutler, Karen Davis, Kristof Stremikis, "The Impact of Health Reform on Health System Spending," Center for American Progress Commonwealth Fund, Vol. 88 (May 2010), at *http://www.commonwealthfund.org/~/media/Files/Publications/Issue%20Brief/2010/May/1405_Cutler_impact_hlt_reform_on_hlt_sys_spending_ib_v4.pdf* (June 22, 2010); The Lewin Group, "Patient Protection and Affordable Care Act (PPACA): Long-Term Costs for Governments, Employers, Families and Providers," June 8, 2010, at *http://www.lewin.com/content/publications/LewinGroupAnalysis-PatientProtectionandAffordableCareAct2010.pdf* (June 22, 2010).

that the costs involved with implementing and maintaining the technology will outweigh any savings in efficiency.

CBO estimates that while investments in health care IT may increase the deficit in the short run, they may in the long run help reduce costs in the private sector and save taxpayers money. In 2008, CBO stated, "Evidence from the literature on health IT…does not uniformly support the possibility of such savings.… In addition, savings are difficult to assess because the trimming of costs in one area of a physician's practice, for example, may be offset by increased costs or reduced efficiency in another area." More optimistically, economists in support of PPACA have suggested that health care IT will reduce spending by as much as 1.5 percentage points.

Administrative Costs.[8] Thirteen cents out of every dollar received in health insurance premiums goes toward "overhead" or administrative costs. These costs, which are separate from the benefits paid by insurance companies, are driven primarily by costs associated with marketing, medical underwriting, billing, and the complexity of benefits. Furthermore, administrative costs are determined by the total number of beneficiaries covered rather than health care spending and may therefore account for a different portion of the premium over time.

Some of PPACA's supporters have suggested that by pooling individuals through an insurance exchange and standardizing health insurance plans, administrative costs could decline to less than 10 percent of premiums. CBO estimates a reduction in premiums for small groups by 1–4 percent, while large group premiums have virtually no impact at 0.4 percent. On the other hand, the Lewin Group—a health care and human services policy research and management consulting firm—suggests that the costs of administering the insurance exchanges will increase total administrative costs over the period from 2010 to 2019 by about 5 percent.

Precarious Beliefs. CBO had an enormously difficult task in attempting to model the effects of health care legislation. The legislation fundamentally changes almost one-fifth of the U.S. economy and has many far-reaching effects. With legislation this complex, some CBO estimates will be wrong. This calculator examines what happens when other esteemed economists and analysts present alternative views to CBO scores.

By rule, CBO has to score what the legislation says will happen. Other policymakers are not bound by such rigid constraints and can take into account other factors, such as popularity among politicians and voters. Thus certain provisions (such as the Medicare cuts) may never come to pass due to politics. This calculator shows what happens to the official score if certain provisions are changed or erased. Forecasting is a difficult business, and beliefs that the health care bill will lower budget deficits are precarious.

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8. Douglas W. Elmendorf, Director, Congressional Budget Office, "Letter to the Honorable Evan Bayh, Speaker, U.S. Senate"; David M. Cutler, Karen Davis, Kristof Stremikis, "The Impact of Health Reform on Health System Spending"; The Lewin Group, "Patient Protection and Affordable Care Act (PPACA): Long-Term Costs for Governments, Employers, Families and Providers."