



# Policy Memorandum

ECONOMIC POLICY INSTITUTE • APRIL 23, 2009 • POLICY MEMORANDUM #141

## WHY A PUBLIC INSURANCE PLAN IS ESSENTIAL FOR HEALTH REFORM

BY ALEXANDER HERTEL-FERNANDEZ

Many leading policy makers, including President Obama and Senate Finance Committee Chairman Max Baucus, have argued that the creation of a public insurance plan is a necessary part of comprehensive U.S. health care reform. This public insurance plan would compete directly with private insurers within a new national insurance exchange. Americans in the exchange would be able to choose between an array of private plans, or the new public plan, within a marketplace that ensured a common set of rules for all insurers. Some have argued that a well-designed exchange with sufficient regulations would make a public plan option unnecessary. This is unlikely to be the case, as a public plan provides crucial benefits to the U.S. health care system *even within a well-designed exchange*.

More specifically, a public plan option would:

- ***Introduce competition to previously limited markets.*** Far too much of our health care system is characterized by limited or non-existent competition, both in the market for insurers as well as the market for providers. This lack of competition is a major source of the United States' uniquely high and rising health costs. A public plan option would force private insurers to compete on efficiency and quality, rather than on their ability to enroll the lowest-cost workers and firms. Furthermore, a public plan would introduce competition to currently monopolistic or oligopolistic insurer and provider markets—three or fewer insurers account for at least 65% of market share in 36 states.<sup>1</sup> The situation is even worse in markets for small businesses, where a single insurer in each state generally controls half of the market for health insurance coverage. Further, consolidation of health care *provider* (especially hospital) markets has also limited insurers' ability to competitively bargain for lower rates.<sup>2</sup> The presence of a heavily concentrated provider market can increase prices for the same treatment by 40% or more.<sup>3</sup> The public plan would guarantee competition even in these consolidated markets, leveraging its size and efficiencies to bargain for the most efficient rates with health care providers.<sup>4</sup>

Some fear that the public plan will use existing Medicare payment levels to reimburse hospitals and physicians, resulting in providers limiting access for the public plan enrollees. Similarly, others would restrict the ability of

---

the public plan to bargain for its payments levels in order to protect physicians and hospitals from being under-reimbursed.<sup>5</sup> Both of these fears are unfounded as long as a public plan is allowed to negotiate its own rates. If a public plan chooses payment levels that drive away providers, discontented enrollees will switch to a private plan. Since the public plan is competing directly with private insurers, it has an incentive to keep both providers and enrollees satisfied.

- **Reduce costs.** Based on the success of other public health insurance plans (such as Medicare) in reducing administrative costs, the independent Lewin Group estimated that a public health insurance plan would have significantly lower operating costs, resulting in windfall savings for employers and enrollees. Moreover, a public plan would not have to earn profits, as most private insurers must do. All told, these savings for employers from an illustrative public plan could total \$25.4 billion in the first year of operation.<sup>6</sup> Premiums for potential enrollees would also be 20% to 30% lower than for comparable private plans.<sup>7</sup>

Recent research from the Congressional Budget Office and other health care experts has indicated that fundamental changes to insurance markets, like the introduction of a public plan option, will be necessary to introduce meaningful cost control. We cannot rely solely on changes to our health care delivery system, like health information technology or comparative effectiveness research, which will both require many years of operation before realizing savings.<sup>8</sup> Furthermore, these sorts of delivery reforms would be much more effective in a more unified system, rather than the current fragmented structure. The potential cost savings of a public plan are also borne out by experiences from the majority of other advanced post-industrial economies. These countries all make greater use of public insurance and have significantly lower system-wide and individual-level costs for health care.<sup>9</sup>

- **Drive quality advancement and innovation.** A public insurance plan would be able to introduce quality advancements and innovation that profit-seeking private plans currently do not have the incentive to implement, given short-term commitments to their enrollees and fragmented delivery and insurance systems. Both Medicare, our nation's largest public insurance program, and the Veterans' Health System, the largest public delivery system, have spearheaded important innovations in payment methods, care delivery, and health information technology.<sup>10</sup>
- **Serve as a benchmark for the insurance market.** Public-private competition is a longstanding feature in the vast majority of advanced postindustrial economies, particularly in health care. Private and public insurers each bring different strengths and weaknesses to the marketplace, complementing one another. One of public insurance's key strengths is the ability to set a high standard for cost, quality, and access within a national marketplace, to the benefit of private and public insurers, providers, and enrollees alike. If enrollees are unsatisfied with the public plan, they would be able to easily switch back to private insurers.

For more information on the need for a public plan in health reform, read the brief *The Case for Public Plan Choice in Health Reform* by Dr. Jacob Hacker, and his related brief, *Healthy Competition*, which outlines how such a public plan might be structured. Both are released by the Institute for America's Future.

---

## Endnotes

1. J. Robinson. 2004. "Consolidation and transformation of competition in health insurance." *Health Affairs*, 23 No. 6, pp. 11-24.
2. C. Capps and D. Dranove. 2003. "Hospital consolidation and negotiated PPO prices." *Health Affairs* 23 no 2 , pp. 213-19; A. Cuellar and P. Gertler. 2003. "Trends in hospital consolidation." *Health Affairs* 24 No. 6, pp. 77-87.
3. L. Dafny. 2005. *Estimation and Identification of Merger Effects*. Northwestern University Department of Economics Working Paper.
4. J. Robinson (2004).
5. L. Nichols and J. Bertko. 2009. *A Modest Proposal for a Competing Public Plan*. New America Foundation Policy Brief (2009).
6. J. Sheils. 2008. Cost Impact Analysis for the "Health Care for America" Proposal.
7. J. Sheils (2008).
8. Congressional Budget Office. 2008. Budget Options Volume 1: Health Care (2008); T. Marmor , J. Oberlander, and J. White., 2009. "The Obama administration's options for health care cost control." *Annals of Internal Medicine*. Vol. 150, No. 7, pp. 485-89.
9. G. Anderson, U. Reinhardt, P. Hussey, et al., 2003. "It's the prices, stupid: Why the United States is so different from other countries." *Health Affairs*. Vol. 22, No.3, pp. 89-105.
10. J. Hacker. 2008. *The Case for Public Plan Choice in Health Reform*. Institute for America's Future Policy Brief. pp13-16.