THE WHITE HOUSE

February 25, 1994

The Honorable Richard K. Armey
U.S. House of Representatives
Washington, D.C. 20510

Dear Congressman Armey:

Thank you for sending the economic and financial analysis of the Health Security Act prepared by the Republican staff of the Joint Economic Committee. I have asked that you be provided with answers to the questions you have raised.

I look forward to working with you in the coming weeks and months.

Sincerely yours,

Hillary Rodham Clinton

Congress of the United States

JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5(a) OF P.L. 304, 79TH CONGRESS)

Washington, DC 20510-6602

January 24, 1994

The First Lady
Hillary Rodham Clinton
The White House
Washington, D.C. 20500

Dear Mrs. Clinton:

The Republican staff of the Joint Economic Committee has done an economic and financial analysis of the Health Security Act (HSA) entitled "A Billion Dollars A Day: The Financing Shortfall in President Clinton's Health Care Proposal." The study reveals a financing shortfall of at least one trillion dollars in the first seven years of the Administration's health care proposal. A copy of that study is attached for your information.

This paper raises disturbing questions about the true cost and the real consequences of the Health Security Act. Before Congress decides on any health care bill, the public should know the answers to these questions.

Therefore, we attach a list of Findings contained in the JEC/GOP staff study and respectfully request that the Administration provide answers to the questions that follow

We thank you in advance for your cooperation.

Sincerely,

Dick Armey

Richard K. Armey (R-TX)
Republican Member
Joint Economic Committee

Jennifer —
Paul Jamison in the War room (6-2566) has information for this response and wants to help. Pls. call him. Thanks.
— Nicole

DRAFT

ANALYSIS OF THE JEC/GOP'S *"THE FINANCING SHORTFALL IN PRESIDENT CLINTON'S HEALTH CARE PROPOSAL"*

OVERVIEW

The Administration finds numerous errors in the methodology and findings of the recent analysis of the President's Health Security Act released by the Republican members of the Joint Economic Committee (1/24/94). These errors render all of the study's scenarios under reform -- enormous deficit increases, broad-based tax increases and rationed health care -- not credible.

The JEC/GOP's study rests primarily on two flawed claims about the Health Security Act, both of which the Administration strongly disputes:

- *First, the study's authors claim that even given the Administration's assumptions, the level of available funding is insufficient to meet the Administration's targets for national health spending, revealing "an inherent financing gap" of $918 billion between 1995 and 2000.*

The study's central finding derives from both fundamental methodological and conceptual errors. Unrealistic growth assumptions for non-premium private spending and government spending account for the study's finding of a financing gap, but the charge also reveals a more fundamental misunderstanding of the national health accounts; if "available funding" falls short of projections then so does spending, and by the same amount. Therefore the JEC/GOP study implicitly predicts that Clinton plan will cost hundreds of billions less than the Administration predicts and that the plan provides more than adequate discounts for businesses and individuals.

- *Second, the study's authors claim that the Administration has vastly underestimated the cost of the benefits package and has overestimated the ability of the new system to control costs, leaving a realistic financial shortfall of $1.8 trillion by the year 2000.*

Again, the JEC/GOP's analysis relies on erroneous assumptions about the composition of the benefits package, the average percent of business payroll necessary to fund reform, and the plan's cost control mechanisms to reach its far-fetched conclusions.

AVAILABLE FUNDING

There is no structural financing gap in the Health Security Act. The source of the perceived financing gap cited in the JEC/GOP study comes from the study's erroneous assumptions of growth rates for non-premium private expenditures and government spending. However, the study's hypothesis of a financing gap reveals a more profound conceptual error that implicitly confirms the availability of discounts for individuals and businesses and projects that the Clinton plan would cost hundred of billions less than even the Administration projects. If available Federal funds for health spending were lower than projected, no gap would emerge. The only effect would be to lower the amount of national health expenditures and increase Federal savings above the levels currently projected.

Comparison of JEC/GOP and Administration Estimates of Available Funds for Health Reform ($ in billions)

Year	Government		New Premiums		Other Private		Total	
	GOP	Adm.	GOP	Adm.	**GOP**	**Adm.**	GOP	Adm.
1995	503	504	282	278	**185**	**290**	970	1072
1996	561	580	307	295	**197**	**304**	1065	1179
1997	628	646	325	312	**203**	**332**	1156	1290
1998	698	716	339	328	**209**	**363**	1246	1406
1999	738	761	353	343	**213**	**388**	1304	1492
2000	794	826	368	359	**216**	**412**	1378	1597
Totals	3922	4033	1974	1915	**1223**	**2089**	7119	8036

Private Spending

- As the above table indicates, the major discrepancy between the estimates of "available funds" between the Administration and the JEC/GOP study comes from non-premium private ("Other Private") health care spending; from 1995 to 2000, this category accounts for $866 billion out of the $918 billion "financing gap" claimed by the study's authors.[1]

- The JEC/GOP study mistakenly assumes that the Health Security Act constrains all private health spending (including private expenditures for additional insurance and out-of-pocket spending for services not included in the benefits package) at the same rate. But this conclusion defies

[1] The JEC/GOP study actually underestimates the amount of new premiums by $59 billion.

reason; there is nothing in the Health Security Act to constrain spending for these services. By contrast, the Administration projects that non premium private spending, such as adult dental care and nursing home expenditures, will grow at the rate projected by the Congressional Budget Office (CBO) in its most recent forecast for private health care expenditures.[2]

Example: CBO projects that total health insurance premiums will be $343 billion in 1995. The Administration's estimate ($282 billion) and the JEC/GOP's estimate ($278 billion) of mandated premiums are similar for that year. But the JEC/GOP study claims that the approximately $65 billion in other private spending for non covered services in 1995 will be held to the same rate of growth as covered services. By contrast, the Administration estimates that spending on these non covered services and additional health insurance will continue to grow at the same rate that CBO projects it would without reform. This error accounts for a $65 billion discrepancy in 1995.

- The JEC/GOP study underestimates private health spending by a rising margin in the outyears. The study predicts that the ratio of other private health spending to private insurance gradually declines from 1995 to 2000 by about 2.5 percentage points as a share of total private spending. This assumption, combined with the study's method of computing non premium private health expenditures, implies a lower growth rate for non covered services than for covered services.[3] However, since non covered services are not constrained by the plan's premium caps, the study's projection is exactly the opposite of what can reasonably be expected under the President's plan.

Government Spending

- The balance of the "financing gap" can be explained by a different baseline between the Administration and the JEC/GOP study's estimate of available government spending.

- While the JEC/GOP study uses the CBO baseline for government spending, the Administration uses a derivative of the CBO baseline, based on more realistic inflation assumptions for government health care

[2] The Administration's estimates for the "other private" category are projected to grow at the same growth rate as CBO projects, after an adjustment for the small difference in assumptions about general price inflation. See CBO Memorandum "Projection of National Health Expenditures: 1993 Update", October 1993, pg. 21.

[3] The JEC/GOP study's projected growth rate for non covered services is about 3.1 percent per year on average compared with an average growth rate of 5.5 percent for the JEC/GOP estimate of mandated premiums.

spending. CBO assumes overall prices will rise about 3 percent per year after 1995. The Administration assumes 3.5 percent overall inflation, which is built into the Administration's projections of national health expenditures. [WHY IS OURS THE BETTER BASELINE?]

COST OF BENEFIT PACKAGE & UNIVERSAL COVERAGE

The other main component of the JEC/GOP's analysis criticizes the Administration's estimates of guaranteeing a benefits package under universal coverage. The study finds that a realistic cost estimate of these benefits reveals that the Health Security Act would cost $1.8 trillion more from FY 1995 -2000 than the Administration projects.

Again, the JEC/GOP's analysis reveals profound methodological flaws and selective interpretation of the Health Security Act's proposals to reach its conclusion of enormous cost overruns. There are three fundamental flaws in the JEC/GOP conclusions about cost estimates:

- First, the JEC/GOP study implies that the Health Security Act will cover benefits that are not covered under the plan.

- Second, the JEC/GOP's estimate of average payroll used as the benchmark for financing reform is wrong because it includes populations covered by many firms today that companies won't be responsible for covering after reform.

- Third, the JEC/GOP's study does not factor in <u>any</u> savings from both the plan's main cost control mechanism -- managed competition through the alliance structure -- and the premium caps, which are the fail-safe, back-up method of cost control.

Benefits Package

- The Health Security Act will provide a comprehensive package of benefits that is comparable to those offered by several Fortune 500 companies. However, the JEC/GOP study ascribes benefits to the Health Security Act -- such as adult dental benefits and certain mental health benefits -- that are covered by many Fortune 500 plans but that are not part of the Health Security Act's standard package.

- Ironically, the study's effort to enlarge the composition of the benefits package -- "*a significant increase in the level of coverage currently enjoyed by the general population*" -- is contradicted by its claim in another part of

the study that "*the Health Security Act entails a reduction in the quality of coverage currently enjoyed by individuals.*"[4]

Benchmarks for Change/Demand Increase

- The JEC/GOP study estimates that a nationwide average of 12.5 percent of payroll in 1995 will be spent by firms on their employees' health care costs, while the Administration's proposal includes caps between 3.5 and 7.9 percent of payroll on premiums, depending on firm size and wage level. The 12.5 percent average in the JEC/GOP study is misleading because it includes populations whose benefits are paid for by firms today but who are covered by government discounts under reform. Including these populations in the payroll average skews the percentage of payroll much higher than it would be under the Health Security Act. Early retirees and "corporate free riders" provide the best example of the effect of this assumption:

  Example: Today, many Fortune 500 firms pay 100 percent of the health care costs of their retirees. Under the Health Security Act, the Federal government will pay for 50 percent of the premium that employers now pay for their early retirees (aged 55 to 64) for three years and 100 percent of the employer share of the premium after the three year phase-in; generally, the retiree will pay the 20 percent family share of the premium percent of poverty. Therefore, the JEC/GOP's method of including this population in expected payroll contributions inflates the average payroll necessary to fund reform.

  Example: The study makes a similar error by including "corporate free riders" -- spouses who receive coverage through their husband's or wife's firm -- in the average payroll. Under reform, these individuals will receive their coverage through their employer or through government discounts. Including this population in payroll average under reform distorts the average payroll even more.

DO THEY INCLUDE DISCOUNTS FOR FIRMS IN CALCULATING AVERAGE PAYROLLS?

- Further, the JEC/GOP study predicts that "*numerous provisions of the Health Security Act will boost demand considerably...since employees explicitly pay a maximum of 20 percent of the average cost plan, tax free, as well as small out-of-pocket expenditures in a regional alliance, they will tend*

[4] JEC/GOP pgs. 7, 33

to choose deluxe plans."[5] This statement contains both factual and deductive errors. First, under the Health Security Act, an individual's premium contribution is paid in after-tax, not pre-tax, dollars. [CHECK] Secondly, since individuals can choose from among a variety of plans, both these individuals and their employers have a clear incentive to choose cost-conscious plans. Third, the administration has incorporated significant demand increase into its cost estimates.[6]

Cost Control Mechanisms

Managed Competition:

- The Administration was extremely conservative in including savings from managed competition from the alliance structure in its financing calculations. However, despite numerous examples of proven cost effectiveness of managed care such as Xerox and Digital, the JEC/GOP study includes none of the savings from managed competition -- the primary means of cost control under the Health Security Act -- in its calculations.[7] Instead, the study simply dismisses the ability of managed competition to realize any savings, relying on a false analogy to the Medicare and Medicaid programs to argue that costs must escalate under the President's plan.

- While the study refers to a number of CBO documents, it ignores CBO's findings that up to 10 percent savings can be achieved by moving all Americans into managed care programs.[8]

- By refusing to allow that any savings from managed competition are possible, the JEC/GOP's implication is that the current health care market is perfectly competitive. The volume of evidence against this claim is enormous and irrefutable.

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[5] JEC/GOP pgs. 12,13

[6] See "The Health Security Act: A Financial and Distributional Analysis" 12/93

[7] In 1991, Xerox changed to a modified low cost pricing strategy. Each year all participating plans are reviewed to ensure that they meet high quality standards and offer comprehensive benefits packages. Premium increases for all health care plans -- especially the benchmarks -- have fallen significantly. As a result, Xerox estimates that enrollment in the lower cost more competitive plans was up 30 percent, and saving of up to $1,000 per year for each employee who switched was achieved. Similarly, Digital switched to a low cost pricing strategy in 1991. They estimate that their savings will amount to $1,400 per employee by 1997, which translates into 1993 savings of $20 million, rising to $63.5 million in 1997.

[8] See CBO Staff Memorandum "The Potential Impact of Certain Forms of Managed Care on Health Expenditures", August, 1992.

Premium Caps:

- Not only do the study's authors discount any savings from managed competition, but they also completely exclude from their analysis any impact of the premium caps -- the fail-safe mechanism that will ensure that individual and business premiums do not exceed the budgeted rate of growth.

- The study's references to cost controls in the Health Security Act reveal a contradiction illustrative of the flawed logic in the JEC/GOP study. On the one hand, the study makes numerous references to price controls and global budgets in the President's plan, implying that the plan's limits on how fast the average individual's business' premium can go up are workable and effective. However, if the premium caps are effective, than the apocalyptic budget deficit and/or tax increases predicted in the second half of the report won't occur.[9]

CONCLUSION

The Administration welcomes constructive debate over financing health care reform. Unfortunately, the profound methodological and factual errors throughout the JEC/GOP's analysis do not help advance this debate. The only two independent studies of the plan's financing by the Congressional Budget Office and the Lewin-VHI consulting firm, have essentially validated the Health Security Act's financing:

CBO: *"Once the Administration's proposal was fully implemented, it would significantly reduce the projected growth of national health expenditures...By 2004, CBO projects that the total spending for health would be $150 billion or 7 percent below where it would be if current policies and trends continue."* [10]

Lewin-VHI: *"...if the question is whether they can finance this program with the revenues they will get under their plan, the answer is yes, and they will still end up with $25 billion for budgetary deficit reduction."*[11]

More information on the plan's financing can be found in the President's FY 1995 budget proposal.[12]

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[9] JEC/GOP Introduction, pgs. 5, 13, 21.
[10] CBO "An Analysis of the Administration's Health Proposal" 2/9/94, pg. 26
[11] Lewin-VHI and Washington Post 12/9/93
[12] See President's FY 1995 Budget request: Chapter 4, "Reforming the Nation's Health Care System to Provide Health Security for All Americans" 2/7/94