The Economics of Health Insurance

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Atlanta Fed economist Melinda Pitts discussed her new research with her Bank colleagues prior to its publication. Photo by David Fine

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Health insurance is more than a vehicle for affordable access to health care for individuals. It is also a shield against financial ruin from huge health expenses.

Not surprisingly, losing that protection can result in problems, according to new research by Federal Reserve Bank of Atlanta research economist Melinda Pitts and three coauthors. Pitts, Laura Argys, Andrew Friedson, and Sebastian Tello-Trillo examined the financial fallout for about 200,000 people who were removed from the rolls of TennCare, which is Tennessee's Medicaid program, in 2005 and 2006 in a cost-cutting move. The economists' findings suggest several adverse outcomes that can persist for several years, including lower credit risk scores, more delinquent debt, and an increased likelihood of bankruptcy.

The TennCare work appears to be the first research to examine in detail the financial consequences for individuals of losing public health insurance. Most earlier studies of health insurance and individuals' finances explored the effects of extending coverage to previously uncovered groups. That research has found that expanding public health insurance programs generally improves household finances.

For those who lost TennCare as part of the disenrollment begun in 2005, the financial ramifications were similar to what Americans on average felt from the 2001 recession. "So it's not a mild impact," Pitts says. Indeed, the paper notes that although it is not possible with available data to evaluate precisely the impact of disenrollment on any single individual, the research suggests "the individual impact of insurance loss is severe, decreasing credit risk scores and increasing bankruptcy risk."

Health economics critical in public policy, society

This paper is the latest product of Pitts's ongoing exploration of health economics. The director of the Atlanta Fed's Center for Human Capital Studies, Pitts studies the ways that public policy and risky individual behavior affect people's finances. Argys and Friedson, both of the University of Colorado–Denver, are visiting scholars with the Atlanta Fed center. Tello-Trillo is an assistant professor of public policy and economics at the University of Virginia's Frank Batten School of Leadership and Public Policy.

A research economist for 20 years, Pitts finds that health economics pervades society and public policy. For starters, health care makes up a large segment of the nation's economy. In 2015, health care spending through private and public insurers totaled $2.4 trillion, accounting for 13 percent of U.S. gross domestic product (GDP), according to the federal Centers for Medicare and Medicaid Services (CMMS). (Total health care spending was $3.2 trillion, or 18 percent of GDP.)

Health is also critical to human capital—the skills, knowledge, and personal attributes an individual brings to the labor market. A person's physical well-being profoundly affects the individual's ability to work, earn, and generally contribute to the nation's economy. Moreover, health insurance is crucial to financial as well as physical well-being, as a big unexpected health care

expense can be financially debilitating. An earlier study found that about 116,000 American households each year experience a health care shock exceeding $125,000.

Finally, health care is an enormously important public policy concern. In the year ended September 30, 2016, Medicare, Medicaid, and the Children's Health Insurance Program provided health care for one in four Americans, with a combined budget of $943.8 billion, according to the CMMS's fiscal year 2016 financial report. So, Pitts points out, it is critical that people making policy and their advisers understand the economics involved.

That final point, in fact, is central to the new working paper. As Pitts, Argys, and Friedson were working on an earlier paper on the effect of debt on mortality risk, Tello-Trillo was researching how the loss of public health insurance affects health outcomes.

"So it seemed a natural extension of both works to examine the financial impact of losing public health insurance," Pitts says, "especially given it was such a key issue in the presidential election and remains a critical public policy question."

In some fashion, change probably coming to public health insurance

The new work is indeed timely. It appears likely that the Affordable Care Act (ACA), which broadened health insurance coverage in part by expanding Medicaid eligibility, will be scaled back. In fact, the cuts in TennCare were "exactly the type of rollback that has been proposed by the American Health Care Act (AHCA), which passed the U.S. House of Representatives in early 2017," Pitts and her collaborators write. What's more, the population that lost TennCare coverage—mostly childless adults—is similar to the group added to the public insurance rolls under the recent Medicaid expansions via the ACA.

The fate of federal health care policy is uncertain. But Pitts and her coauthors say their findings are a "cautionary tale" regarding the potential financial consequences for individuals who could lose health insurance coverage because of federal policy changes. The economists write that if health care costs grow faster than federal funding for Medicaid—a likely scenario under an AHCA proposal that would reduce federal contributions to states—states will face a dilemma. They can either raise additional tax revenue or shrink their Medicaid programs. States and the federal government share the costs of Medicaid, and in fiscal year 2016, the federal share was 63 percent.

TennCare issues go back more than 20 years

The roots of TennCare's funding issues date to the early 1990s. A special tax on hospitals that helped to fund the program expired in 1994, and the state did not extend it. As the end of that revenue stream approached, the state elected to institute a managed-care delivery system. Through supervision, monitoring, and advising, managed-care programs aim to ensure a uniform standard of care, performance, and cost control. Tennessee's state government intended to enroll all Medicaid beneficiaries in a managed-care organization, envisioning that the reforms would cut spending per beneficiary and create enough savings to expand eligibility.

But managed care did not live up to its promise, Pitts says. After about a decade, as other priorities competed for state general fund dollars, officials chose to pare TennCare rolls by 170,000 people. At peak enrollment in 2001, the program covered slightly more than 1.4 million people.

Pitts's research estimates that the impact of one person being removed from Medicaid is a drop in that person's credit risk score of about 21 points, triple the average credit score decline for Americans during the Great Recession.

Meanwhile, the share of debt that is delinquent rose 5 percentage points for the average disenrolled Tennessean, and the likelihood of entering bankruptcy within two years rose just over half a percentage point. In all, the negative effects of losing TennCare eligibility were more severe among those who already had lower credit scores, the researchers found.

Pitts and her coauthors will continue researching the many links between health care and household finances. One of the data sources the economists used, the Federal Reserve Bank of New York Consumer Credit Panel/Equifax, includes more than 600 potential indicators of financial well-being. Those data are rich material for exploring a number of issues, Pitts says. To hear more about this research, listen to a new *Economy Matters* podcast featuring Pitts.

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