

# Continuing Market Turmoil Bodes Ill for Health Care System

*Lance Heineccius*

With the 1995 repeal of comprehensive health reform in Washington State, the local health care system entered an era in which competitive market forces, rather than government planning, have become the dominant influences shaping the health system's future. After five years of this paradigm, the results are discouraging. Growing market turmoil seems likely to further disrupt access to health care for vulnerable populations such as the uninsured, rural residents, and people with serious illness or chronic conditions. Such disruption could increase the challenges facing public health services.

The health care "market" is defined by the interactions among patients, providers, consumers, insurers, purchasers of insurance (mainly employers and government), and the complex federal and state regulatory structure. Access to health insurance is decreasing while health insurance premiums rise; nearly all health plans have lost money in recent years

and some smaller insurers have gone under; hospital margins are shrinking and expected to get worse; physicians are frustrated with health plan interference, administrative burden, and constraints on their income; and consumer trust in the health care system is steadily eroding. Government, at both the state and national levels, has shown little leadership on health care in the past five years — although the campaign rhetoric for 2000 increasingly includes some health issues.

Consolidation has become a major trend for health-related businesses: mergers, acquisitions, and reformations of business entities that, for the most part, are designed to achieve economies of scale, expand market share, and make health-related companies more competitive. Health plans have consolidated dramatically (Table 1), and additional consolidations may raise antitrust concerns.

The benefits of health plan consolidation have yet to become clearly evident. The hoped-for economies of scale have not been realized thus far, as system integration challenges continue to increase overhead costs. To date, major health plans are not experiencing postmerger market share growth, while new market entrants such as First Choice and Community Health Plan of Washington have shown respectable growth.

Competition has increased, but the major visible effect has been abandonment of unprofitable lines of business or geographic areas. For example, many managed care plans have discontinued serving rural counties, and individual insurance remains unavailable in most Washington counties (as of September 2000). Many health plans are also discontinuing their participation in government programs such as Healthy Options, Basic Health, and Medicare + Choice. Few health plans in Washington have reported an underwriting surplus in recent years.

Figure 1 presents health plan losses in 1997, 1998, and 1999 for the major insurers in Washington State. Midyear data for 2000

**Table 1: Consolidation in health plans in Washington since 1994**

1994	2000
Blue Cross of Washington and Alaska	
Medical Savings Corporation	Premera BlueCross
QualMed (Eastern WA)	
Network Health Plan	
Pacific Health Plan	PacifiCare of Washington
QualMed (Western WA)	
Ethix (later NYLCare)	
Virginia Mason Health Plan	Aetna US Healthcare
Aetna Health Plan	
King County Medical	
Pierce County Medical	
Good Health Plan of WA	
Clallam County Physicians	Regence BlueShield
Grays Harbor Medical	
Walla Walla Valley Medical	
Skagit County Medical	Northwest Medical
Whatcom County Medical	

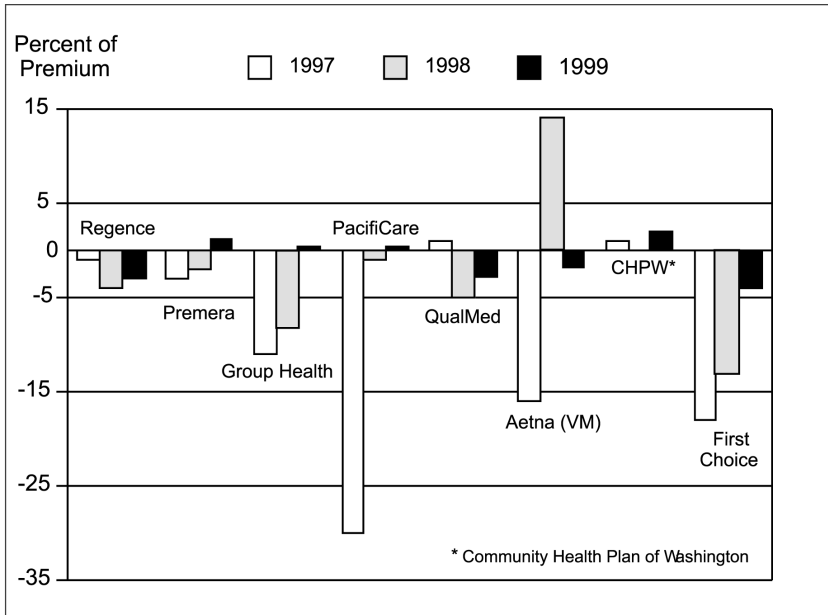
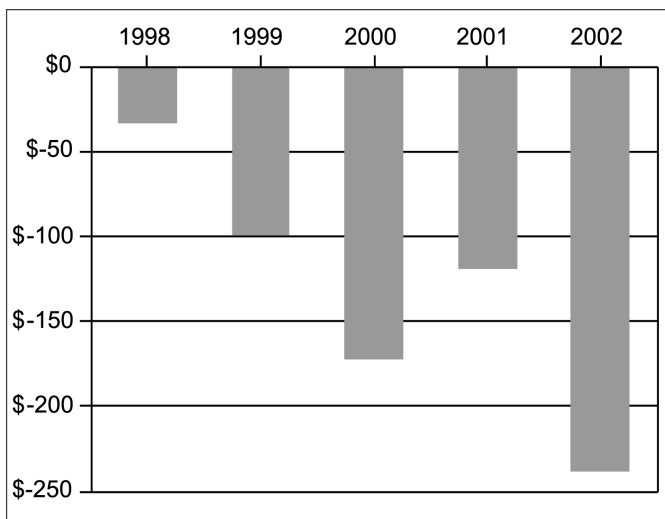


Figure 1: Underwriting margins for Health Plans in Washington State, 1997 to 1999.  
Source: Health plan filings with the Office of the Insurance Commissioner.

indicate minor improvement, but most plans still had slightly negative underwriting margins at midyear. These underwriting losses do not reflect interest earnings on reserves and other income, which allowed most health plans to operate in the black in recent years. The net worth-to-losses ratio for several plans is problematic, however, so additional plan failures and forced consolidations may occur.

Hospitals in Washington have not yet seen major consolidations, with the exception of the Swedish takeover of Providence Hospital in Seattle. Worsening financial status may force further consolidations (or closures) in coming years. Through 1998 hospitals were actively purchasing primary care physician practices, a form of vertical rather than horizontal consolidation. The new trend appears to be for hospitals to divest or restructure physician-business relationships, primarily for economic reasons. Another major economic trend for hospitals and other providers is declining Medicare revenues due to cuts imposed by the federal Balanced Budget Act of 1997. Figure 2 shows the estimated reductions in Medicare revenues for Washington hospitals. Cuts will be phased in over five years ending in 2002, with the largest reductions scheduled for the last three years. One estimate suggests these cuts will represent roughly 2% of annual hospital expenses each year. Recent congressional action has moderated or deferred some of those expected cuts.

Figure 2: Expected reductions in Medicare revenues for Washington State hospitals due to the Balanced Budget Act of 1997.  
Source: Washington State Hospital Association.



Health insurance purchasers (employers and government) are viewing the most recent round of health plan premium increases with alarm. After relatively low annual increases in the mid-1990s, most health plan premiums are now increasing at double-digit rates. One strategy that many purchasers are considering, or have already adopted, is a “defined contribution approach.” The purchaser sets a fixed amount to contribute annually toward the purchase of employee health benefits (the defined contribution) and the employee or beneficiary must make up the difference to purchase insurance coverage that costs more than the contribution. In a robust economy with a tight labor market, few employers have been willing to shift a major portion of premium costs to employees, but many are already setting up the infrastructure to be able to do so in the event of an economic downturn.

Smaller businesses are more likely to simply discontinue health benefits altogether in an

economic downturn. One additional factor worth following is whether proposed federal regulations for a patient bill of rights will allow employees to sue self-funded employer health plans. If this occurs, some experts predict that most self-funded plans will be eliminated and that employers may instead offer their employees a voucher for purchasing health insurance (or possibly even health services) on the open market.

In Washington State, this voucher approach may prove difficult given the instability in the individual health insurance market following the repeal of universal access in 1995. Adverse selection, a short preexisting condition exclusion period, and a requirement for guaranteed issue made this market unprofitable. Citing excessive losses, the few health insurers offering individual health insurance policies froze enrollment in 1998 and 1999 and refused to sell new policies. The 2000 Legislature has provided at least a temporary fix for these problems, but the longer term financial viability of individual and small-group health insurance for higher-risk (sicker) persons remains uncertain.

### *Implications for the Public Health System*

What does this market turmoil mean for the public health system in Washington? Four potential impacts seem likely in the coming years:

- **More uninsured:** Health plan abandonment of unprofitable business lines and geographic areas, combined with rapidly escalating premiums and employers shifting more of the premium costs to employees, are likely to result in an increasing number of uninsured persons in many areas of the state. To the extent the uninsured need primary medical care, they may seek services from local public health programs and local emergency rooms. Handling this increased but unfunded demand for direct service delivery could pose a serious challenge to many local public health jurisdictions, especially in the wake of I-695, the voter initiative that repealed the motor vehicle excise tax and cut state revenues.

- **Barriers to access in rural areas:** Even without the insurance problems, more rural residents are expected to encounter access difficulties if rural hospitals are forced to close due to insufficient payment levels from

## **Strains on the Rural Health Care Safety Net**

*by Vickie Ybarra*

Progressive health care policy has placed safety net providers in rural Washington State in a somewhat better position than rural providers in other states. From my perspective, however, serious access issues remain for rural residents of our state. The three primary issues I see as most pressing to the survival of the rural health care safety net are Medicaid managed care, rural hospital viability, and health profession development.

Medicaid managed care has created unique challenges in rural areas. Even in areas that have health plans willing to contract with Medicaid, the lack of sufficient specialty providers needed to create competition on fees can be a serious problem. While employers and government purchasers are trying to reduce what they pay to health plans, plans operating in rural areas may not be able to pass those rate decreases along to specialty providers and so are at increased financial risk.

Nationwide, small rural hospitals are closing at an astounding rate. Their disappearance is a concern because these hospitals represent a vital resource for local primary care. Without a local hospital, many primary care and specialty providers are simply not willing to practice in rural areas. For example, it is difficult to recruit a physician to provide primary prenatal care without the opportunity to deliver babies.

Although recruiting physicians may be somewhat less difficult than 10 years ago, provision of primary care (especially in a managed care environment that emphasizes prevention and continuity of care) requires a broad range of other health care professionals. Nurses, pharmacists, dentists, dental hygienists, and lab technicians are also difficult to recruit to rural areas. To solve this problem we need new and creative partnerships that move beyond simplistic clinical placements in rural areas and arrangements with schools to educate these professionals. We know that health profession students from rural areas are much more likely to practice in rural areas. Sites that offer clinical placements for health profession students should have an opportunity to require the health profession school to actively recruit students from their community.

Washington State has made strides in shoring up the rural health care safety net, but to maintain it, health policy must support small rural hospitals and the health plans operating in these areas. Health policy also should encourage health professions schools to recruit from rural areas.

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Medicare. Again, this scenario may place unanticipated and unfunded demands on local health jurisdictions to deal with residents who have no local source of medical care.

- Less money available for community health programs: Many not-for-profit hospitals support a wide range of community health programs that could be jeopardized by financial difficulties. Current programs may be discontinued and new programs appear unlikely given the decreases in net revenue anticipated at most Washington hospitals.

- Opportunities and challenges for joint efforts in prevention and health promotion: Given the increasing focus of health care businesses on the immediate financial bottom line, the longer-term benefits of prevention and health promotion are often ignored and sometimes refuted altogether. The challenges for public health programs are, first, to get the attention of hospitals, physicians, and health plans during these difficult times and, second, to convince them that keeping their enrolled population healthier and identifying illness earlier will be financially advantageous. This will be a tough sell in the near future, as providers and health plans look for new ways to cut costs and avoid higher-than-average-risk patients.

### *Recommended Reading*

Barker K, Varner LK: Health insurance can still be found, but remaining choices likely will be pricey, *The Seattle Times*, September 3, 1999, p 3.

Heineccius L: *Health Care Futures*. Seattle: Washington State Hospital Association, 1999, pp 78–86, 128–130.

Tiscornia J, Baumgartner D (Arthur Andersen LLP): *The Balanced Budget Act of 1997: Effects on Healthcare Operations*, presented at The Washington State Hospital Association Annual Meeting, Seattle, Oct. 14, 1999.

Wendleton J: *Profile of Washington State Health Plans*. Seattle: Washington State Hospital Association, 1999, pp 1–12.

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