



# The Affordable Care Act's Lower-Than-Projected Premiums Will Save \$190 Billion

By Topher Spiro and Jonathan Gruber     October 21, 2013

The Affordable Care Act is already working: Intense price competition among health plans in the marketplaces for individuals has lowered premiums below projected levels. As a result of these lower premiums, the federal government will save about \$190 billion over the next 10 years, according to our estimates. These savings will boost the health law's amount of deficit reduction by 174 percent and represent about 40 percent of the health care savings proposed by the National Commission on Fiscal Responsibility and Reform—commonly known as the Simpson-Bowles commission—in 2010.

Moreover, we estimate that lower premiums will lower the number of uninsured even further, by an additional 700,000 people, even as the number of individuals who receive tax credits will decline because insurance is more affordable.

In short, the Affordable Care Act is working even better than expected, producing more coverage for much less money.

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## Marketplace plans and tax credits

Under the Affordable Care Act, marketplaces that offer health plans to individuals are now open in every state. The federal government is operating marketplaces in 36 states, and 14 states and the District of Columbia are operating their own marketplaces. Marketplace plans offer five levels of coverage—catastrophic, bronze, silver, gold, and platinum—ranging from less generous to more generous.

Individuals with family income from one to four times the federal poverty level (about \$26,000 to \$94,000 for a family of four)—and who are not eligible for other qualified coverage—are eligible for tax credits to help cover the cost of a plan. The tax credit caps the amount an individual must pay for the second-lowest-cost silver plan at a certain percentage of family income, ranging from 2 percent of income at the poverty level to 9.5 percent of income at four times the poverty level.

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## Price competition in the marketplaces

When the nonpartisan Congressional Budget Office, or CBO, projected premiums under the Affordable Care Act before its enactment, it theorized that increased competition would lower premiums in the individual market—but only slightly.<sup>1</sup> In CBO’s view, marketplaces that organize the market—making it easier for consumers to compare choices—would encourage plans to keep premiums low to attract consumers.

CBO’s theory has turned out to be right in reality—only more so.

In an analysis of plans offered in the marketplaces, the McKinsey Center for U.S. Health System Reform found that new entrants into the market make up 26 percent of all insurers.<sup>2</sup> These new entrants are introducing competitive pressures into the individual market. The McKinsey analysis found that new entrants tend to price their plans lower than the median premiums in their market.<sup>3</sup>

Moreover, in a preliminary analysis of plans offered in 18 areas, the Kaiser Family Foundation found that premiums are lower than CBO’s projected premiums in 15 of those areas.<sup>4</sup>

In March 2012, CBO projected an average family premium for the second-lowest-cost silver plan in 2016.<sup>5</sup> This projection is equivalent to an average individual premium in 2014 of \$4,700 (see sidebar). The *actual* average premium for the second-lowest-cost silver plan in 2014 turned out to be \$3,936—16 percent lower than projected.<sup>6</sup>

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## Impact on costs and coverage

Premiums for the second-lowest-cost silver plan are important because tax credits for individuals are based on the cost of that plan. If premiums for that plan are lower, then the cost of tax credits will also be lower.

Consider a typical individual making \$30,000 a year. That individual’s premium contribution would be capped at 8.37 percent of income, or \$2,512. If the premium for the second-lowest-cost silver plan is \$4,700, then the tax credit would be the difference between this premium and the individual’s contribution, or \$2,188. But if the premium for the second-lowest-cost silver plan turns out to be only \$3,936, then the tax credit would be \$1,424.

### CBO’s projected premium levels

In March 2012, CBO projected an average family premium for the second-lowest-cost silver plan of \$15,400 in 2016.<sup>7</sup> This family premium is equivalent to an individual premium of \$5,700 in 2016. CBO projected that private insurance premiums would increase by 5.5 percent per year from 2014 to 2016, so its estimate for 2014 would be lower by that amount. In addition, the Affordable Care Act covers the cost of high-risk enrollees through 2016, but it provides greater relief in 2014 than in 2016. This reinsurance will lower premiums by more in 2014 than in 2016. Taking the estimate of \$5,700 in 2016, trending it backward by 5.5 percent per year, and accounting for greater reinsurance in 2014 yields an estimate of \$4,700 in 2014.<sup>8</sup>

We estimate that a 16 percent reduction in premiums will lower the total cost of tax credits by about 21 percent. As the example above illustrates, the percentage reduction in the tax credit will often be much greater than the percentage reduction in the premium. Because the amount that individuals pay is fixed at a percentage of income, a reduction in premiums will result in a proportionally larger reduction in government spending.

In its May 2013 baseline, CBO projected that the tax credits would cost \$920 billion through 2023.<sup>9</sup> But CBO made this projection before data on actual premium rates became available. A 16 percent reduction in premiums will lower this cost by about 21 percent, or about \$190 billion.

Another result of the reduction in premiums is that more individuals will take up coverage because it is even more affordable. We estimate that a 16 percent reduction in premiums will lower the number of uninsured by an additional 2.8 percent. Because CBO had projected a decline in the number of uninsured of 25 million by 2023, this means that an additional 700,000 people will gain coverage. (See Methodology for more information on our estimates.)

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### \$190 billion in context

When it was enacted, the Affordable Care Act was already fully paid for and projected to lower the federal budget deficit. In its most recent estimate, CBO projected that the law would lower the deficit by \$109 billion over the next 10 years.<sup>10</sup> Our estimated \$190 billion in savings will increase that deficit reduction by 174 percent to almost \$300 billion.

Recent long-term debt-reduction plans have proposed substantial health care savings in combination with additional tax revenue. The Simpson-Bowles commission, for example, proposed \$487 billion in health care savings.<sup>11</sup> And in the last “grand bargain” offer that President Barack Obama made to House Speaker John Boehner (R-OH) in December 2012, he proposed about \$400 billion in health care savings.<sup>12</sup>

Our estimated \$190 billion in savings represents a sizable share of these proposals’ health care savings—about 40 percent of the Simpson-Bowles plan’s savings and almost half of the president’s proposed savings.

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## Conclusion

In the spring, CBO will update its baseline projection of the Affordable Care Act. When it does, the agency will take into account the actual experience of premium rates for plans offered in the marketplaces in 2014—which are significantly lower than projected. We estimate that the savings to the federal government will be about \$190 billion over the next 10 years. This is an important early indication that the Affordable Care Act is working even better than expected to lower health care spending and federal deficits.

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## Methodology

We used the Gruber Microsimulation Model, or GMSIM, to model the impact of a 16 percent reduction in premiums for plans in the individual market. Microsimulation modeling uses evidence from health economics studies to model how individuals and employers respond to changes in policy or the environment. The Congressional Budget Office uses the same type of modeling.

The GMSIM is designed to closely match CBO estimates that have been released to date. While our estimates are not guaranteed to exactly mimic what CBO would find for a comparable reduction in premiums, our findings should provide a reasonable approximation of CBO's findings.

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## Endnotes

- 1 Letter from Douglas W. Elmendorf to the Honorable Evan Bayh, November 30, 2009, available at <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/107xx/doc10781/11-30-premiums.pdf>.
- 2 McKinsey Center for U.S. Health System Reform, "Emerging exchange dynamics: Temporary turbulence or sustainable market disruption?" (2013).
- 3 Ibid.
- 4 Cynthia Cox and others, "An Early Look at Premiums and Insurer Participation in Health Insurance Marketplaces, 2014" (Washington: The Henry J. Kaiser Family Foundation, 2013), p. 8, available at <http://kaiserfamilyfoundation.files.wordpress.com/2013/09/early-look-at-premiums-and-participation-in-marketplaces.pdf>.
- 5 Congressional Budget Office, "CBO and JCT's Estimates of the Effects of the Affordable Care Act on the Number of People Obtaining Employment-Based Health Insurance" (2012), available at [http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-15-ACA\\_and\\_Insurance\\_2.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-15-ACA_and_Insurance_2.pdf).
- 6 Office of the Assistant Secretary for Planning and Evaluation, Health Insurance Marketplace Premiums for 2014 (U.S. Department of Health and Human Services, 2013), table 4, available at [http://aspe.hhs.gov/health/reports/2013/marketplacepremiums/ib\\_premiumslandscape.pdf](http://aspe.hhs.gov/health/reports/2013/marketplacepremiums/ib_premiumslandscape.pdf). The national premium is an average weighted by enrollment in each state, and is based on premiums for plans offered in the federal and state-based marketplaces as of September 18, 2013.
- 7 Congressional Budget Office, "CBO and JCT's Estimates of the Effects of the Affordable Care Act on the Number of People Obtaining Employment-Based Health Insurance."
- 8 For more details, see Laura Skopec and Richard Kronick, "Market Competition Works: Proposed Silver Premiums in the 2014 Individual and Small Group Markets Are Nearly 20% Lower than Expected" (Washington: U.S. Department of Health and Human Services, 2013), p. 11, available at [http://aspe.hhs.gov/health/reports/2013/MarketCompetitionPremiums/rb\\_premiums.pdf](http://aspe.hhs.gov/health/reports/2013/MarketCompetitionPremiums/rb_premiums.pdf).
- 9 Congressional Budget Office, "Table 3. Health Insurance Exchanges: CBO's May 2013 Baseline," available at [http://www.cbo.gov/sites/default/files/cbofiles/attachments/44190\\_EffectsAffordableCareActHealthInsuranceCoverage\\_2.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/44190_EffectsAffordableCareActHealthInsuranceCoverage_2.pdf) (last accessed October 2013).
- 10 Letter from Douglas W. Elmendorf to the Honorable Paul Ryan, May 15, 2013, available at <http://www.cbo.gov/sites/default/files/cbofiles/attachments/hr45.pdf>.
- 11 Moment of Truth Project, "Updated Estimates of the Fiscal Commission Proposal" (2011), available at [http://www.momentoftruthproject.org/sites/default/files/UpdatedEstimates6292011\\_0.pdf](http://www.momentoftruthproject.org/sites/default/files/UpdatedEstimates6292011_0.pdf).
- 12 Office of Management and Budget, Budget of the U.S. Government, Fiscal Year 2014 (Executive Office of the President of the United States, 2013), p. 35, available at <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2014/assets/budget.pdf>.