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JOHN H. SYKES COLLEGE OF BUSINESS

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HEALTH INSURANCE AND THE ECONOMICS OF THE INDIVIDUAL MANDATE

by Richard B. Smith, Ph.D.

There have been no less than 27 lawsuits challenging various provisions of the Patient Protection and Affordable Care Act (health care reform law) since it was signed by President Obama in March 2010. Most of the cases have focused, though, on a particular provision of the Act requiring "maintenance of minimum essential coverage," otherwise known as the individual mandate. The mandate basically requires that every American, starting in 2014, have health insurance or pay a penalty. Four of the court cases have risen as high as the U.S. Courts of Appeals, and in one of these, in the Eleventh Circuit (which includes Florida), the mandate was struck down as unconstitutional. Consequently, the United States Justice Department requested that the United States Supreme Court review this decision, which it has agreed to do.

The essential question that is before the Court is whether the Commerce Clause of the United States Constitution (and prior interpretations of that clause by the Supreme Court), which grants Congress the power to regulate the economic activity of an individual, and therefore the power to regulate how an individual would buy a good or service, could extend to the decision of that individual on whether to buy the good in the first place. Whether or not the mandate is considered constitutional in this context, the idea of an insurance mandate is not new. Every state in the country has some minimum requirement of individuals to carry automobile insurance, particularly liability insurance to cover the medical and property expenses of those involved in an accident with the insured driver.

Closer to the issue at hand, Massachusetts enacted a major reform of health insurance in the state in 2006, which included mandates on citizens to have insurance. Indeed, the Affordable Care Act (ACA) was largely influenced by the Massachusetts reform plan. In addition, back in 1993, when President Clinton proposed major reform of the health care system, which did not include an individual mandate, several Senate Republicans, led by John Chafee of Rhode Island, proposed an alternative plan—which included an individual mandate. Thus, despite the controversy surrounding ACA's individual mandate, there seems to be some general agreement that mandates to carry insurance can make sense, and may even be necessary. Moreover, given the economic basis of the question that now resides within the Supreme Court, it would seem natural to turn to economic principles to aid in understanding the logic that underlies this reasoning.

To begin, there is approximately $55 billion in health care services provided, annually, to individuals without health insurance, individuals who are generally, by law, not required to pay for these services. This cost is not, however, merely absorbed by the providers of these services (i.e., physicians and hospitals), but is typically transferred, or shifted, from the service providers to patients with insurance, who ultimately pay for this uncompensated care in the form of higher insurance premiums.

In addition, health-related expenses are the leading cause of personal bankruptcy in the United States, a cost that is also partly borne by others in society. For economists, these are examples of negative externalities. Technically speaking, a negative externality occurs whenever a party who is not directly involved in an economic transaction bears, nonetheless, some portion of the cost of the transaction. The negative externalities associated with being uninsured are considerable, and indeed, economic.

In addition to the external costs borne by society, the decision to purchase health

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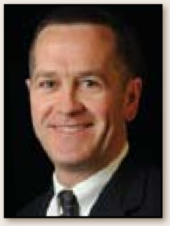
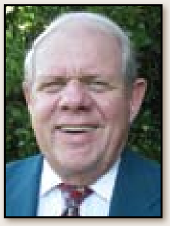
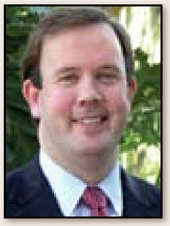
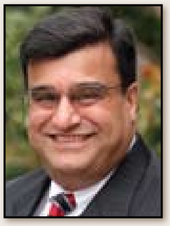
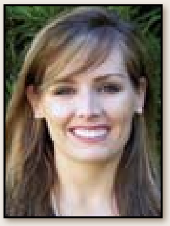








F. Frank Ghannadian, Ph.D.
Dean, John H. Sykes College of Business



Lindsey E. Smith
Production Coordinator

EVOLUTION OF THE GLOBAL ECONOMIC ORDER: THE IMPACT OF BRICS, HIICS, AND PIIGS

by Michael H. Truscott, Ph.D.

The world economy and the international financial system have been profoundly affected by changes in certain economies that impact world economic growth. There has been a shift in the balance of economic and financial power from the "old-industrialized" economies to the newly "emerging" economies. For the last half-century the drivers of world economic growth were the European Union, United States, and Japan.

However, for the last 10 years, and into the foreseeable future, the newly emerging economies have and will play a leading role in the growth of the world economy. This change in connectivity and economic interdependence has resulted in a new world order, which has important implications for the future of the global economy. Three groupings of countries comprise the new world order: BRICs, HIICs and PIIGS.

The BRIC countries—Brazil, Russia, India and China—represent rapidly growing emerging economies, which will soon have a dominant role in the determination of world economic growth rates. For example, China's GDP is projected to surpass United States' GDP within the next 10 years, assuming China continues to grow at their current average annual growth rate of 10 percent and the growth rate in the United States averages three percent over the same period. Thus, China will be the world's largest economy within the next decade or so!

This is not to say that the average Chinese citizen will have a comparable standard of living as the average citizen living in the United States. Standard Chartered Global Research (2010) reports that real GDP per capita in 2010 was U.S.$4,166 in China and U.S.$45,561 in the United States. By 2030 it is expected to rise to U.S.$21,420 in China and U.S.$66,073 in the United States (see table 2.1). Although the gap in each country's living standard would remain wide, China will have experienced a 500 percent increase in real GDP per capita compared to a 45 percent increase in real GDP per capita in the United States.

The rapidly rising standard of living in China (and in the other BRIC countries) gives rise to a very large and growing class of middle-income consumers. These new consumers provide the world's multinational corporations with new foreign investment opportunities. They will also stimulate imports, helping to fuel world growth. It is projected that emerging economies will import more goods than developed economies in 2012. China is expected to overtake the United States as the world's biggest importer by 2014.

According to Standard Chartered Bank's The Super-Cycle Report (2010), the European Union, United States, and Japan created 60 percent of global GDP in 2010 (Figure 2.1). China and India combined contributed 11 percent of global GDP in 2010. The report's projections for 2030 show a very different world. In 2030, today's emerging economies will produce 61 percent of global GDP, with China producing 24 percent and India 10 percent (Figure 2.2). However, global GDP produced by the European Union, United States, and Japan will decrease to 29 percent in 2030.

Clearly there will be a "New Normal" in terms of the drivers of world economic growth in the coming years. By 2030, the BRICs will replace the old-industrialized economies as the locomotive driving world economic growth. As a result, BRICs will significantly impact aggregate demand in the European Union, United States and Japan by generating new jobs in exporting industries. Old-industrialized economies will become increasingly less important to the wellbeing of the rest of the world, both economically and politically. World political and economic power will shift as the old-industrialized economies seek to make new ties with BRICs and because BRICs will assume more political clout in world institutions such as the World Trade Organization, International Monetary Fund and the United Nations.

Figure 2.1

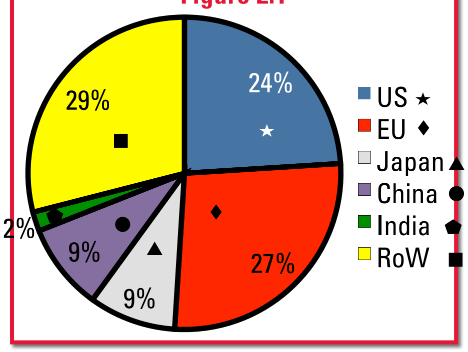
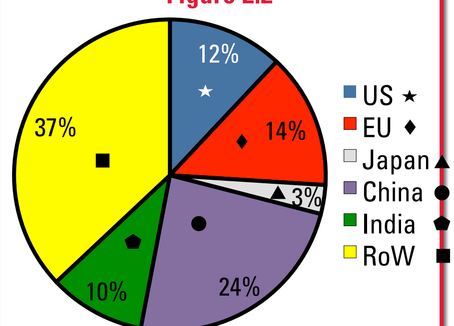


Figure 2.2



The European Union, United States and Japan have struggled over the last decade with increasingly large budget deficits and national debts, earning them the new moniker of "highly indebted industrialized countries" (HIICs). According to the IMF Global Financial Stability Report (2011), national debt-to-GDP ratios for 2011 are expected to settle in at 88 percent for the European Union, 100 percent for the United States, and 230 percent for Japan. These high debt levels are because of easy fiscal policies during the last decade, which were adopted to stimulate growth between 2001 and 2006, to combat the economic effects of the great recession between 2007 and 2009 and to battle the effects of slow growth and high unemployment since 2009. The HIICs, however, face a dilemma in pursuing policy strategies that are incompatible with attaining the goals of high employment and lower budget deficits. In addition, fiscal authorities in the HIICs will be buffeted by a demographic tsunami as the number of retirees is expected to rise sharply over the coming decade.

The political pressure on the HIICs to reduce budget deficits, both in the near term and in the long run, will result in tighter fiscal policies, which will reduce growth rates. Needless to say, these countries are now making debt reduction a key goal, requiring either a decrease in spending or an increase in taxes, either of which would exacerbate a fledgling economic recovery in these countries. Clearly the goal of budget deficit reduction is proving to be very difficult in the United

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insurance also has implications for the general stability of insurance markets. When individuals have a choice, there is a tendency for only those who expect to experience a loss to buy insurance, while those less at risk avoid it. Under these conditions, insurers have to set premiums relatively high because of the high expected costs associated with their enrollees. As premiums are raised, more individuals will drop coverage, leading to even higher costs and premiums. Economists refer to this as a process of adverse selection, which means from the insurers' perspective there is an undesirable proportion of high-risk individuals enrolled in insurance plans. In the extreme, adverse selection can lead to a death spiral of ever-escalating insurance premiums and, ultimately, a breakdown of the insurance market.

A specific example of the insurance market death spiral occurred in 1995, when Harvard University introduced what is known as a voucher system for employee health insurance. Instead of subsidizing plans according to the generosity of the benefits offered, under the voucher system, the university paid the same fixed amount, for all plans, on behalf of its employees, with employees expected to pay any additional premium for the plans they chose. Because only the high-risk (less healthy) employees still found the most generous plans attractive under this system, the employee price for these plans rose by over $500 annually. Within three years after introducing the voucher system, the market for the most generous plans disappeared entirely.

By requiring that all Americans (by 2014) have health insurance, the individual mandate of the Affordable Care Act (ACA) addresses the real and serious problems of externalities and adverse selection in health care and insurance markets. In that sense, there is an economic basis for the mandate, and so it would seem to fall within Congress' constitutional power, as articulated in the Commerce Clause. However, given, the constraint the mandate places on individual freedom, we might consider alternatives to the mandate that would preserve the freedom to choose whether or not to buy insurance while still addressing the economic problems of externalities and adverse selection.

One alternative would be to provide subsidies to encourage the purchase of health insurance. Indeed, one reason adverse selection may not be more of a problem in the United States is because most Americans already benefit from a feature of the federal tax code that excludes employer (and employee) contributions to health insurance from taxable income. For some individuals, that benefit is enough to encourage obtaining health insurance when they would otherwise not. The main benefits of the tax exclusion are that it minimizes adverse selection, while not being, of course, compulsory. The major drawback of subsidies is that they are not the most efficient way to alter economic behavior. From an economic perspective, an individual will more readily respond to the threat of losing a $1 for not behaving in a prescribed way than being rewarded with a $1 for behaving in a prescribed way. In other words, ACA would be far more costly if it relied only on subsidies to achieve universal insurance coverage (or actually, coverage of 95 percent of the population, as it is expected to achieve).

Another alternative to the mandate would be to self-insure. That is, for individuals to regularly put aside a portion of their income as protection against future and unexpected health expenses. In today's insurance markets, these kinds of personal funds are known as health (or medical) savings accounts. Health savings accounts (HSAs) are often combined with a basic insurance policy to cover major, or catastrophic, medical events. The economic appeal of these kinds of plans is that they are attractive to the relatively healthy members of society because the premiums are relatively low. With low premiums, out-of-pocket costs, in the form of deductibles, tend to be high, but that is of little concern to a healthy individual. For those who are less healthy, the high deductibles present more of a problem, although the savings-account component of the plans can be used to cover these out-of-pocket costs. Thus, a health insurance system based on HSAs could address the problem of

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States because of bipartisan bickering. A compromise in the near term does not appear to be in the cards.

The economic situation in Greece and Italy and the spread of this contagion to the HIICs is further proof of the interdependence between the world's major economies and the PIIGS. PIIGS is the acronym given for the countries Portugal, Ireland, Italy, Greece and Spain. The PIIGS will most likely have to default on their sovereign debt because of extraordinarily large current budget deficits and a huge national debt.

Italy has the third largest bond market in the world and these bonds are widely held by banks and other financial intermediaries in Europe, the United States and Asia. A default by Italy on its debt would have serious worldwide repercussions. Furthermore, although the European Union has the financial resources to provide a bailout for Greece, their resources are insufficient to provide assistance to a country the size of Italy. So the PIIGS are contributing to economic problems experienced in the HIICs, no doubt resulting in a slowing of world economic growth. This slowdown in world economic growth in turn will affect growth prospects in the BRICs.

In conclusion, the global economic order is evolving. Its impact on the global economic landscape requires a new approach to meet the challenges imposed by increased worldwide economic connectivity. National economic strategies and policies will have to be developed to emphasize more than just domestic goals. Now more than ever, economic strategies and policies must incorporate international variables as a crucial component of overall economic policy. A very important but uncertain outcome at this time is what role China, and to a lesser extent Brazil and India, will play in assuming their new leadership roles in driving world growth.

Write to Professor Truscott at
mtruscott@ut.edu.

THE TAMPA BAY ECONOMY

by Brian T. Kench, Ph.D.

The Tampa Bay metropolitan statistical area (Hernando, Hillsborough, Pasco and Pinellas counties) continues to recover from a severe economic downturn. Gross sales in Tampa Bay total $8.8 billion in October 2011, a 10 percent increase from October 2010 (see figure 3.1). Gross sales in Tampa Bay have returned to pre-recession levels. Indeed, since the end of the great recession, the year-on-year change in gross sales has increased by 0.65 percent per month.

The data in figure 3.2 reveals that nonfarm payroll jobs in Tampa Bay have increased for 10 months, on a year-on-year basis. A similar trend exists for Florida and the United States. Figure 3.3 illustrates the duration of job loss in Tampa Bay in the 2007-2009 recession relative to the 1990-1991 and 2001-2003 recessions. The figure illustrates how hard the recession has impacted the labor force in Tampa Bay. In the 1990-1991 recession, it took 32 months to claw back to the level of nonfarm payroll jobs that existed prior to the recession. In the 2001-2003 recession, it took 46 months. As of October 2011, 46 months have passed since the recession began and the area remains net negative 107,600 jobs. Although Tampa Bay is slowly adding nonfarm payroll jobs, many months, if not years, will pass before Tampa Bay observes the number of nonfarm payroll jobs that existed prior to the recession.

The labor force participation rate (percent of the population in the labor force) for Tampa Bay is reported in figure 3.4. The labor force is measured as those persons who are employed plus those who are unemployed and actively seeking employment. In the first 10 months of 2011, 46.8 percent of the Tampa Bay population, which equals 2.8 million persons, participated in the labor force. Although the area observed a slight increase in the labor force participation rate at the end of the housing bubble, since the beginning of the great recession the rate has continued its decline.

A related statistic is the unemployment rate, which we measure as a ratio of those unemployed and looking for work divided by the labor force. In Tampa Bay, the unemployment rate was 10.3 percent in November 2011, which is higher than the national unemployment rate by 1.7 percentage points and 0.5 of a percentage point higher than the unemployment rate for the state of Florida. In the same month, the unemployment rate was 13.1 percent in Hernando County, 9.8 percent in Hillsborough County, 11.4 percent in Pasco County, and 10.0 percent in Pinellas County.

Figure 3.5 *(see page 5)* shows Standard & Poor's Case-Shiller housing price index (HPI) for Tampa Bay, which is based on observed changes in home prices in the area. Tampa Bay's seasonally adjusted HPI hit its maximum value of 239.05 in May 2006. Since that time, the HPI has dropped 47.7 percent to its lowest post-bubble reading of 125.08 in September 2011.

Figure 3.6 *(see page 5)* shows the absolute number of privately-owned, one-unit residential permits for new homes in the Tampa Bay area. New permits for October 2011 totaled 354. In 2005, the Tampa Bay area averaged 2,263 permits per month. In first 10 months of 2011, the Tampa Bay area averaged 375 permits per month—an 83 percent decline in average monthly permits relative to the 2005 peak. Clearly, this is a signal that the housing industry remains weak.

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Figure 3.1: Gross Sales in Tampa Bay: January 2007 – October 2011
Source: Florida Department of Revenue

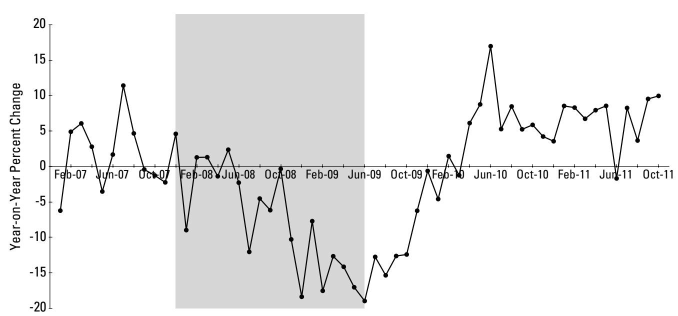

Figure 3.2: Nonfarm Payroll Jobs: January 2000 – October 2011
Source: Bureau of Labor Statistics

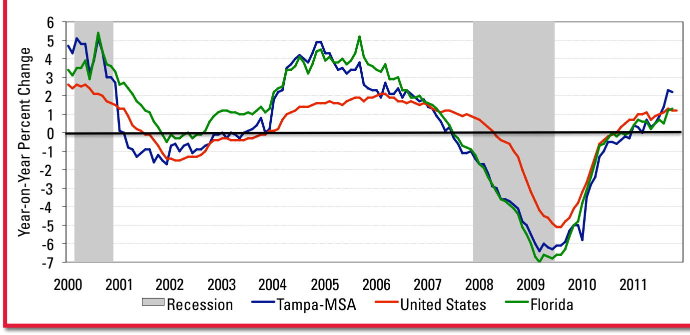

Figure 3.3: Duration of Job Loss in Tampa Bay
Source: Bureau of Labor Statistics

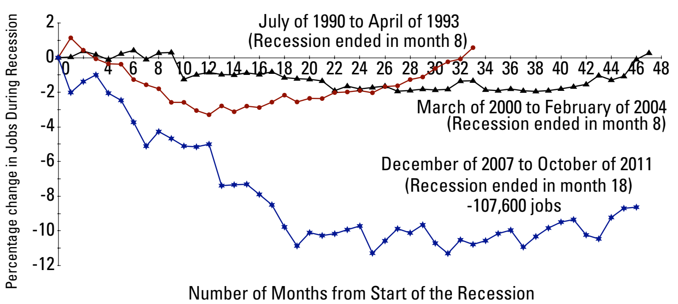

Figure 3.4: Labor Force Participation Rate in Tampa Bay: 2002-2011
Source: Bureau of the Census and Bureau of Labor Statistics

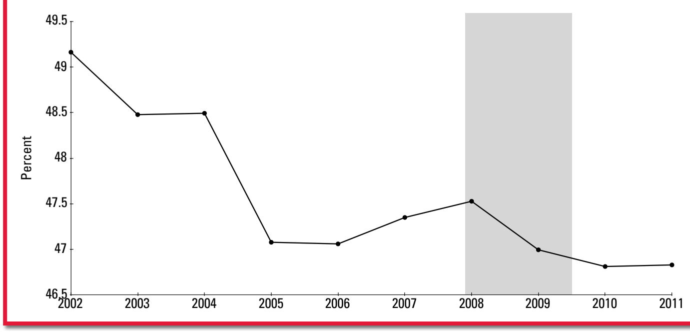

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Figure 3.7 reports the homeowner vacancy rate in Tampa Bay. A housing unit is considered vacant if no one is living in it at the time of the survey taken by the Bureau of the Census. A vacant unit may be one which is entirely occupied by persons who have a usual residence elsewhere or a new unit not yet occupied. Units exposed to the elements and units entirely used for nonresidential purposes are excluded from the calculation. The Tampa Bay homeowner vacancy rate peaked at 5.1 percent in 2007, just after the housing bubble popped. However, the homeowner vacancy rate remains elevated. For the first 10 months of 2011, the rate in Tampa Bay equals 4.1 percent.

Figure 3.8 reports the rental vacancy rate for Tampa Bay, which measures the proportion of the rental inventory that is vacant and for rent. Interestingly, the rental vacancy rate spiked from 7.8 in 2006 (Tampa Bay's peak year in S&P's Case-Shiller HPI) to 15.4 percent in 2008 (the beginning of the great recession). From the beginning of the great recession to today the rental vacancy rate has continued to decrease.

In summary, recent data continue to point in a positive direction. Gross sales in Tampa Bay are back to pre-recession levels. And the area is adding nonfarm payroll jobs—the year-on-year change in nonfarm payroll jobs has been positive for 10 months. Despite these positive telltales, the housing market and labor market remain weak. It will likely take years for Tampa Bay to recover from the damage left behind by the great recession.

Write to Professor Kench at bkench@ut.edu.

Figure 3.5: S&P Case-Shiller HPI for Tampa Bay (SA)
Source: Standard and Poors

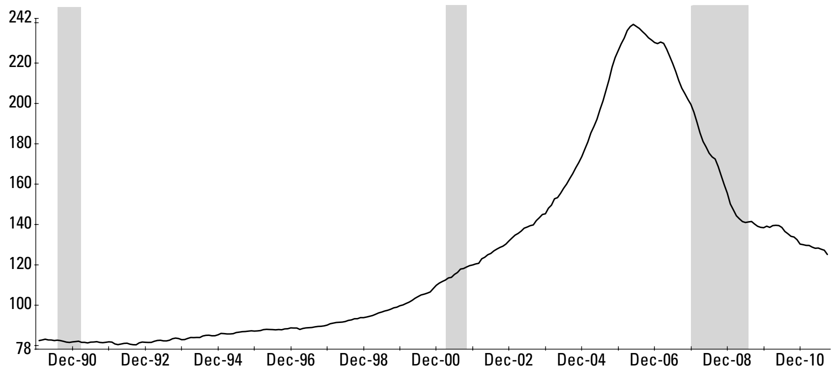


Figure 3.6: Residential Building Permits: January 1990 – October 2011
Source: U.S. Department of Housing and Urban Development

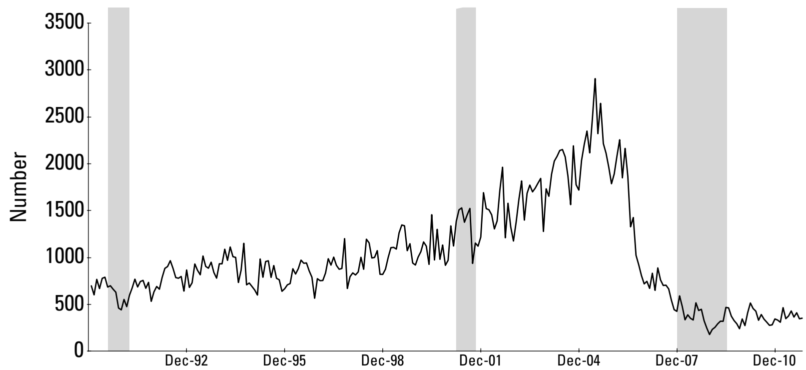


Figure 3.7: Homeowner Vacancy Rate in Tampa Bay: 1986-2011
Source: Bureau of the Census

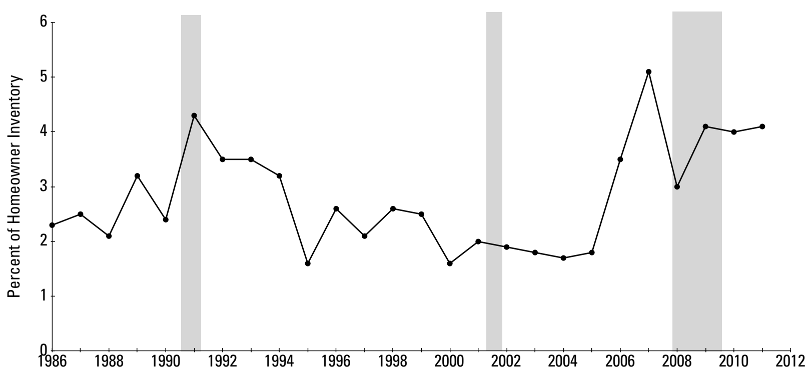
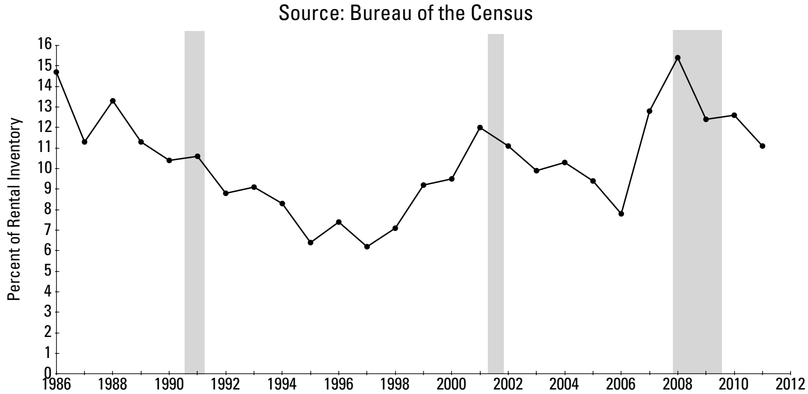


Figure 3.8: Rental Vacancy Rate in Tampa Bay: 1986-2011
Source: Bureau of the Census



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adverse selection because most individuals—even the healthy—would consider such an insurance policy a necessity.

While HSAs have been available for over a decade, the market for these plans has become increasingly popular in the past few years. The percent of workers with employer-based insurance who enrolled in these kinds of plans increased from 8 to 17 percent between 2009 and 2011. A likely reason for such a dramatic swing is the increasing cost of traditional plans, although this, unfortunately, seems to be revealing a serious limitation of HSAs. Recent studies indicate a tendency for these kinds of plans to lead to financial hardship, particularly for individuals and families with chronic conditions who, even with the availability of health savings accounts, may not be able to save enough to cover their high expenses. In fact, this is another example of adverse selection. When HSAs first became available, they immediately attracted the relatively healthy, which increased the cost of traditional plans. As this process has continued over time, even the less healthy have been attracted (or forced) to enroll in HSA-style plans, despite the fact these plans may offer insufficient coverage.

Thus, while there are alternatives to the individual mandate, they come with their own drawbacks. The main drawback of any alternative that would not compel individuals to carry health insurance, HSAs included, is adverse selection. There is, therefore, an economic rationale for the individual mandate. The question is whether that rationale overrides another important idea, particularly in the United States, which is economic freedom. As such, the question of the individual mandate is worthy of a Supreme Court decision.

Write to Professor Smith at smithrb@usf.edu.

The University Of TAMPA

The University of Tampa | John H. Sykes College of Business
401 W. Kennedy Blvd. | Box O | Tampa, FL 33606-1490 | www.ut.edu