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HEALTH CARE REFORM

Leader: DONALD R. SONDERGELD
Guest Speaker: JUDITH FEDER*

MR. DONALD R. SONDERGELD: I would like to introduce Judith Feder, Co-Director at the Center for Health Policy Studies. She will be speaking about Health Care Reform.

DR. JUDITH FEDER: Obviously you're spending a great deal of your time thinking about health care reform, an issue whose place in the political landscape has changed dramatically in the last year. In fact in the 20 years that I've been a student of the politics of health care financing, I can't remember a time when the issue of health care coverage and costs received as much attention as it's now getting.

I want to talk to you about the political environment on health care reform and the way in which that environment is shaping policy action. Specifically, I want to talk about how and why the environment facing us on health care has changed. Why all of a sudden has health care reform become such a visible political issue? Then I want to spend a fair amount of time talking about the policy options for health care reform, ways of responding to the public's concern. Third, I want to shift to the politics and talk about how the political parties view the options. More specifically, given the pressure for reform, what are the parties talking about or proposing to do about it? And finally, taking all of the previous discussion into account, I want to discuss the prospects for reform in the reasonably near future.

Let me start with the change in environment. As I indicated, I've been affected on this issue by my experience on the Pepper Commission, so when I tell you that there's been a change in this environment, I say it to you basically from heartfelt and painful experience. When the Pepper Commission introduced its recommendations for reform roughly two years ago, after a year of very hard work and a lot of negotiating and compromising in order to try to come to consensus, we managed to pass our reforms by an eight to seven vote, a slim majority you might say, only to have our recommendations declared "dead on arrival" by some of the commission's own most influential members who were also members of Congress. Congressman Rostenkowski was one of those who declared it dead on arrival two years ago, and I'm pleased to tell you that he has in the last several months introduced as his own legislation precisely the recommendations that the Pepper Commission made.

Let me talk about why it is that the vote was so close then and why the change now. I think it was well articulated by a member of the commission who did not support the recommendations that the problem facing politicians on health care reform then was that they believed that there was a health care crisis, but they did not believe that their constituents believed there was a health care crisis. In those circumstances, the members clearly found it far more risky to take a stand on

* Dr. Feder, not a member of the sponsoring organizations, is Co-Director, Center for Health Policy Studies, Department of Community and Family Medicine, Georgetown University School of Medicine, Washington, District of Columbia.

health care reform, because there was and is lots of opposition to any particular reform, than if they did not act at all.

I think no one in the Congress would today say the same thing. By late last summer political polls surrounding the presidential election began to indicate that politicians, whether they be Democrats or Republicans, needed to take a stand on health care reform.

In late summer 1991, health care was just beginning to appear on the political polls, up there with the deficit, poverty, education, and homelessness as a significant domestic issue that politicians needed to pay attention to. Then in the fall came the Pennsylvania Senatorial election. Senator Wofford defeated former Attorney General Dick Thornberg in an election in which health and a cry for national health insurance became the watchword of Senator Wofford's successful campaign. Voters were asked to identify the two issues that most influenced their vote for senator, and 50% of Pennsylvania voters identified health care compared to 29% who identified taxes and 21% who identified jobs and the recession. And the exit polls that we've seen after several of the primaries support the view that health care has become a major economic issue. In most of the polls you see jobs and the recession at the top, health care not far behind, and virtually nothing else appears as a major issue.

Politicians looking at this experience know that health care is no longer an issue that they can talk about as a terrible problem and "wouldn't it be nice if we could do something about it?" The fact is that health care has become an issue to middle class Americans. We still hear a lot about, and many care about as we all should, the more than 30 million Americans who are without health insurance coverage. But far more powerful politically is the fact that now the majority of Americans who have insurance have become frightened that they will lose it and are overwhelmed by its costs, along with the costs of care and services that they must pay for directly.

What's brought about this change? The recession and the lay-offs and the general economic restructuring that's going on has certainly contributed to this sensitivity to health care, particularly since we live in a system in which people's health insurance is dependent upon their jobs. But it's not only the recession that is creating this sensitivity. There are also major structural issues in the health insurance industry that I would argue are behind this concern and fear.

The newest factor, I'd say, developing in the last five years, comes from the disintegration of health insurance in the small group market as insurers have come increasingly to compete to avoid risk rather than to share it. When I speak to audiences less knowledgeable than this one, I always make sure to emphasize that this isn't because insurers are evil, although maybe in a sophisticated audience like this, you would disagree. Honestly, I would say that it's not because insurers are evil. It's the nature of a competition. Health insurance is a very expensive product and as employers are concerned about what they're spending on this product, they're looking for good buys. And insurance companies, unfortunately, can give the employers the best buy if they are only insuring perceived good risks and if those good risks stay healthy. The result is that we see premiums varying with health status, with occupational risk, and with other characteristics of employees. We see insurance premiums

skyrocketing whenever somebody gets sick. And we see some firms or individuals within firms virtually unable to obtain insurance at any price.

As you well know, the effects of this kind of marketing behavior go well beyond fast food restaurants and construction firms to lawyers' and physicians' offices and to essentially cover the entire economic spectrum. What that means is that politicians can recognize and can say that hardworking, employed Americans are only one illness, let alone one job, away from losing their insurance.

This is a particular problem of insecurity that arises in small firms. But the insecurity goes well beyond the small firms. Employers in large and small businesses face the increasing burden of health care costs. In trying to cope with those increasing costs, they are continually trying to reduce their benefits, essentially shifting costs to their employees. This means employees are required to pay more of their premiums, especially for their kids, where we've seen a drop-off in private coverage in recent years, more of their physician and hospital bills, and are required to face in some cases limits on the benefits they're able to receive. In many cases, they are faced with restrictions on their choice of providers. All these factors combine to make employees wonder whether the health care they value will be there when they need it.

And finally at the root of these coverage problems, there is the ever-present problem of health care costs, leading to government, businesses, and individuals to ask, "Isn't it possible for us to get the health care we value without paying quite so much or having our costs increase quite so rapidly?"

The bottom line is that these factors combine to mean that the issue of health care coverage and costs can no longer be written off by the well-insured American public as somebody else's problem, a problem for those unfortunate 30-some million who just happen to fall through the cracks. It has essentially become a high priority, economic issue for middle class Americans. And they vote. That's the reason we're seeing a change in the political environment.

Having given you my view on the health care environment, let's talk about the options we face for addressing this insecurity and fear. The options can be arrayed by how much they depart from the current system. And we can evaluate the options based on two sets of factors. One set involves policy judgment: how well does the option achieve universal coverage, that is, health care coverage for all Americans, and how likely is it to contain costs. The second set of factors on which it helps to evaluate options is their political appeal, because that will help you understand what the controversies are surrounding particular approaches.

Let me start with the option that departs the least from our current combination of employer-based and public coverage. That would be an option that proposes policy changes that (1) would fill gaps in coverage in the current system, either by extending Medicaid or providing tax credits particularly targeted to the low-income population, (2) would restore risk-spreading to insurance primarily through underwriting and rating reforms or in some cases risk adjustments to premiums, and (3) would pursue cost containment by facilitating competition among insurers to manage or coordinate care.

The pluses of this option, I would argue, are its avoidance of disruption for the vast majority of the American public. I think that some degree of stability is a policy as well as a political advantage. And the second advantage, I would argue, is that this kind of approach targets public dollars to the population in greatest need, an approach that has considerable appeal given fiscal concerns and a growing opposition to entitlements without regard to income.

But the minuses of this approach are substantial. No analyst would tell you that such an approach will achieve universal coverage or that it will contain costs. The evidence tells us that subsidies to individuals or to small employers on the order that most of these proposals provide will make some improvement in coverage, particularly among the lowest income population, large numbers of whom are not now eligible for Medicaid. They can make some dent, but they will fall far short of assuring universal coverage. Only about a third of the uninsured are poor and most proposed subsidies begin to fall off at 100% of the poverty level and disappear by the time people have incomes at about 150% of the poverty level. What that would mean -- just so that you can grasp why it is that analysts say not everybody will be covered -- is that a family of three with an income of $17,000, 150% of the poverty standard, would get no subsidy. This means that if insurance costs in the neighborhood of $3,000 or $4,000 for family coverage, and it's not so clear that families can get good coverage even at that price, we would be expecting them to pay about 20% of their income in order to get health care coverage for their families. That's not counting the out-of-pocket payments and additional expenses they would have to cover. That's just the insurance protection. We used to call that 20% of income a catastrophic expense against which people should be protected, not one we should expect them to make.

Of course it varies with the plans, but even substantial subsidies that go up as high as 150% or even 200% of poverty are likely to serve only about half the currently uninsured, leaving roughly 20 million people without insurance protection and guaranteeing those whose employers do not provide protection no safety that they could get coverage.

These kinds of proposals are also of questionable merit on cost containment. Even those people who advocate competition as a strategy to achieve cost containment, that is greater competition around delivery as opposed to around risk selection by insurers, feel that significant changes are needed in order to make that competition have even a chance of effectiveness. What these kinds of proposals usually propose is extending managed care options that large employers now take advantage of to small employers. We know from a decade of experience that managed care may bring some one-time savings, but it will not slow the rate of increase in insurance premiums over time. So that option, while it's got some advantages, falls significantly short in terms of achieving a primary policy goal of universal coverage and containing costs.

Now a second option that might be considered an extension of the first would address these two limitations. It would stay with the tax credit approach targeting resources to the low income population and with competition as its basic approach, but it would require all Americans to purchase insurance coverage usually enforced through the tax code. And to give this extra boost to competition that I was talking

about, it would eliminate the preferred tax treatment of employer-paid insurance premiums. Now it would by law achieve universal coverage and it would increase the incentives for consumers to be price conscious shoppers, a change that many believe would lead to a slowdown in the rate of increase in costs and would have consumers assessing value for the dollar. Some argue that's good enough as a cost containment approach.

But significant disadvantages, nevertheless, remain with this approach. First, that elimination of preferred tax treatment of employer-paid premiums essentially represents an increase in taxes for a large number of Americans. And although it can be argued that we would end up with a much more progressive financing structure with tax credits focusing on the low income population and stopping at some point on the income distribution, it would leave many well-off Americans whose dollars are actually being redistributed worse off than they are today. And, again, unless those subsidies are very well structured, the plan may leave a lot of middle income Americans spending far more for their health insurance protection than objectively we would determine they are able to afford. The lowest-income population would benefit from this approach, but many others would be actually at risk and many members of the high-income population, who would have to support it, might see themselves as losers from this type of reform.

The second disadvantage to this kind of approach is that it may actually undermine what are relatively efficient elements of our current health insurance system, that is the pooling of risk in large employer groups. As individuals are encouraged to be sensitive to the price of their insurance, we may encourage them to pull out of those pools seeking for themselves the best deal from a number of insurance opportunities. We know from experience that insurers are awfully effective at attracting good risks and at distinguishing the good risks from the bad. And a system that relies so heavily on this kind of competition may actually cause the risk pooling we still have to come apart even further than it is today. So I would argue that even though that approach can achieve universal coverage and some would argue, though I personally don't share that point of view, that it would contain costs, I think there are substantial risks to moving in this direction.

Now let me move further up the options scale to an approach that explicitly makes a change or departure from the current system. This approach would build a universal system out of the combination of employer-based and public coverage we have today. It would retain employer-based and public coverage, but it would go beyond filling gaps to actually create a system in which everybody's covered. And this approach would do so by requiring employers to provide coverage to their workers and by requiring government to cover all those who are not covered through their employment.

This kind of approach, and I'll talk about it more, is most commonly now referred to as the "pay or play" approach. It pursues cost containment, not so much through the competitive approach or competition among insurers, although it does retain that element, but primarily through a national budget for health care expenditures within which premiums would be limited or providers' rates would be negotiated.

This kind of plan would achieve universal coverage with, I would argue, adequate protection of individuals from excessive out-of-pocket spending. And international experience would tell us that it would contain costs. We know from other countries' experience that national health care budgets and negotiated rates can produce lower rates of growth in health care spending than we experience. We also know we don't have to have one insurer to achieve those lower rates of growth. One insurer is the Canadian model, typically thought of. But Germany, which has multiple insurers, does even better in containing costs than the Canadians do. What we've learned is we don't have to have one insurer. What we need is one set of rules for payment by which all insurers play. So those are the pluses.

The minuses of an employer/public universal approach are that it's administratively messy. People change jobs. They move from insurance plan to insurance plan. They move from employment to unemployment, and we would have to build a system, not beyond our capacity I would argue, in which people can do that in a way that does not interfere with their protection nor with the flow of funds to pay for their care. The second and politically more significant disadvantage to this approach is that it requires mandates on employers that are no more appealing politically than are the mandates on individuals I described to you a few moments ago. These mandates to provide coverage would mean the greatest change for small employers from their current operations. Large employers almost all provide coverage, as do many small employers. But, many of the smallest employers do not. Small employers are well organized to oppose any new requirements that they might be asked to meet. And the final disadvantage of this approach is that, although I've argued to you that it can, if we use it, contain costs, some argue that in using it we will essentially gut or undermine the health care system that we value. So that's the employer/public option with its pluses and minuses.

And now, last, the option that would scrap the current system of employer-based coverage altogether and would replace it with a government-run national health insurance system. The advantages of this approach are, one, it would achieve universal coverage and cost containment, same reasons I argued a moment ago, but it would do so in a way in which nobody would fall through the cracks. No need to integrate plans. Everybody's just covered. This is pretty simple and straightforward. And it would be awfully simple to administer in comparison to the alternatives.

But now we turn to the minuses. We get this simplification because all the dollars and all the people become a public responsibility. Many question whether such a sizable shift from the private to the public sector is intrinsically desirable or is what Americans really want. From a political perspective, the biggest question asked about this kind of approach has to do with the taxes that are associated with financing it. The advocates say that there's no difference between a tax to finance an insurance program and a premium to finance it, particularly if a premium is mandatory. Many would argue a premium is a tax by another name. But there's a very big difference in people's perceptions of that approach when it becomes a tax, and a new tax structure to shift approximately $400 billion from the private to the public sector would create significant numbers of winners and losers with political consequences that most politicians are loathe to face. I would argue that such a big shift would

create so much political disruption that it is very difficult to achieve it in anything like the foreseeable future.

Now as I've walked through the options, you may have noticed that with the exception of this $400 billion for a national health insurance program, I've not mentioned the costs of the other plans. What I want to tell you is there's not one of them that's cheap when it comes to talking about the new taxes that would have to be raised to finance them. The national health insurance program, because it absorbs the bulk of health care spending, from a federal tax perspective, though not from a health care cost perspective, is the most expensive. And the others cost in the neighborhood of $40 billion on an annual basis, whether that's the public share and the subsidies of an employer/public approach or even a decently subsidized incentive approach or a tax credit approach with the tax credits going to the poor. So although there are discussions, and you will see them, I think, from time to time in the press and among the advocates, that we can finance it all through administrative efficiencies, I would caution you to be skeptical about those kinds of claims.

I have talked about the new political environment, and the options. Now let me turn to the partisan politics -- first, the Democrats, then the Republicans.

The Democratic leadership of the Senate sees the present day as an opportunity to pursue universal coverage and cost containment. But the leadership believes it can only achieve this result politically if the solution they propose addresses middle class people's fears without exacerbating their concerns about higher taxes or losing the coverage they value. They believe the employer/public or pay or play approach that I described to you in general terms earlier is a strategy that achieves that goal. Let me now briefly give it to you more specifically, first its key policy characteristics and then what are perceived as its political advantages.

First, a pay or play approach would guarantee all workers coverage through their jobs just the way they now get access to Social Security and are guaranteed an adequate minimum wage. Second, it would guarantee employers access to affordable coverage by giving employers a choice, either to buy coverage in the private sector the way you do now (only the private sector would be reformed through new underwriting and rating regulations) or to purchase coverage from a new public plan at a price that's set as a share of payroll. "Play," buy in the private sector or "pay," get coverage in the public plan. And setting that price as a share of payroll is intended explicitly to set a cap on the liabilities that employers must face.

The third element of the pay or play approach is the government responsibility, essentially a replacement of Medicaid with a decent public program that guarantees coverage of all those not covered in the workplace in the same public plan that employers will use for their employees if they find it financially more attractive. And finally as I indicated the cost containment would be pursued through the creation of a national health expenditure budget and the negotiation of premiums or provider payment rates consistent with that budget.

The perceived political value of this plan is as follows. First, in contrast to a national health insurance plan in which everything becomes public or publicly financed, this approach politicians can say will secure coverage for the middle class Americans

where they have it and where they want to keep it, in their jobs. They don't have to move to a new public plan to get coverage. They're going to be guaranteed they can keep it where they've got it. Second, it retains the private sector which many Americans value, but the plan has the private sector operate within a government framework that protects consumer interests. Third, the plan pursues cost containment by regulating provider incomes, which polls would tell us many Americans think are unconscionably high rather than by telling Americans to go out and be better shoppers. And fourth, it allows universal coverage, just as much protection as a national health insurance program would provide, at relatively low taxes. A $40 billion program may not be cheap, but it's going to mean a lot lower taxes than a $400 billion program would require.

With these features the advocates of the pay or play approach believe they can tell their constituents that reform will make the insured population better off, not worse off, even though it will initially cost more in taxes. (Extra costs of coverage will be offset by cost savings in the long run as cost containment begins to work.) Without that promise, the advocates of reform don't think they've got a chance.

As I said, that is the Democratic Senate leadership's strategy. That doesn't mean it's the strategy of all Democrats. Very briefly, we know that many Democrats, particularly in the House, advocate national health insurance, either because they believe that it's too early to compromise on a system like the one I've described or because they dislike that system, find it too messy and see it having too many inequities to be satisfactory. But whatever the reason, many still believe in a national health insurance system. At the same time, at the other end of the political spectrum within the Democratic party, there are many Democrats who believe that the pay or play system with its costs and its mandates is more controversial than the system can withstand. I would put Senator Bentsen in this camp, as an advocate of insurance reform as a first step and we'll worry about the rest later. So Democrats are far from united, which is one reason we're not expecting action in the next couple of months. But I would argue that as the debate moves forward you will see most likely the pay or play strategy take the lead as the strategy that the Democrats are advocating.

What about the Republicans? The Republicans have taken a very different approach. They are for the most part philosophically opposed to the kind of government intervention that a pay or play system or a national health insurance system would require and are far more comfortable with what I have called the "gap filling" approach, the tax credits and other measures to fill in the gaps. The President believes the best way to appease the middle class and address the health care reform problem is with minimal government interference and a promise that with just a little help from some government regulation and some tax credits the market will indeed make everybody better off.

In brief, the President's proposal for health care reform has the following elements. It emphasizes the importance of insurance reform, the underwriting and rating regulations, to prohibit risk selection and risk-based rating in order to enhance the availability of insurance to more Americans. Second, it advocates competition among insurers, (more) managed and coordinated care to control costs. And third, it provides tax credits to the poorest Americans up to 150% of poverty to enable them to purchase health care in a reformed market.

As I indicated to you that kind of approach can mean substantial improvements in coverage for low-income Americans, but estimates are that it will leave insurance too expensive for at least half the uninsured. But the Administration's belief is that it can promote this plan through a message to the middle class that the current system for health insurance works and with a few new rules and some market changes, everybody will have access to private insurance coverage and the private insurance market can be made to work effectively.

Not all Republicans share this point of view. There are divisions in the Republican party, just as there are among Democrats. Some in the Administration would say, "Let's not move quite so fast with those tax credits." They, like Senator Bentsen, would limit the initial action to insurance reform. And so we've not seen a legislative proposal introduced by the President, and when people talk about the kind of proposal that will be introduced in legislative form, it may well lack that tax credit element and have only the insurance reform component.

We also see a number of conservatives, not so much elected officials, and I'll say why, but outside, who are distressed by the Administration's failure to give that extra boost to competition and greater progressivity to health care financing that would come from a change in the tax treatment of employer-paid premiums. Republican Senator Chaffee's proposal looks similar to the President's and was introduced in advance of that proposal. Both the group that developed that proposal and the group working on the President's proposal reportedly had that kind of tax change under consideration and Senator Chaffee has said quite explicitly that it's just too politically difficult to introduce that element. So you still see some pressure from conservatives to make this a more comprehensive and arguably more effective cost containment approach.

Despite the disagreements within the two camps, it's fair to characterize the Democrats on the one end as willing to pursue government intervention in order to achieve a comprehensive universal coverage and Republicans on the other pursuing an incremental approach that keeps governmental intervention to a minimum.

Let's turn to how we think those two approaches are going to fare. What do they mean for the prospects of health care reform? I think first when we think about that, we want to think about it on the broadest level, probably in the context of the presidential election. I find for myself the best way to think about how these alternatives are going to play politically is to think about the kinds of negative reactions that each proposal is going to get. So when we look first at the Democrats' proposal, I think it's not hard to see what kind of problems they're going to face. I mean, if they're going to go comprehensive and promise a major government role, what they're going to do is raise the specter of government incompetence. And so we will hear as we've already heard that if you want the compassion of the IRS, the efficiency of the Post Office, and the cost effectiveness of the Pentagon, go with the Democrats' proposal. Now since I've probably not kept very well hidden that I've got a lot to do with the Democrats' proposal and tend to favor it, that particular critique gives me a nervous stomach because I believe that it strikes a lot of chords in the voting American public. Furthermore, as the Democrats increasingly push a regulatory strategy for cost containment, they face the prospect of what I heard one reporter call "the Willie Horton of this campaign," the Canadian who comes down and tells you

why he couldn't get health insurance or couldn't get health care in the Canadian system. And I've been on a panel with that person, so I know he's ready to come down. I would argue that those critiques are not justified, that there is not a gutting of the health care system or a nationalizing of the health care system under the Democrats' proposal. But I do believe that's a very powerful political critique.

If the Democrats' risk is the aggressiveness of their action and the change it involves, the risk that the Republicans face is that people will say, "There's no change at all under this proposal." Where's the guaranteed security of coverage? Where is the financial protection for the middle class? All the money in this proposal is redistribution. As I heard a political analyst say, "Taking from those who vote and giving from [sic] those who don't," not exactly a winning political formula. And when critics look at that proposal, they will argue that instead of, as in the Democrats' proposal, having government out there to guarantee all Americans their coverage and reasonable costs, Republicans expect Americans to trust the insurance industry, an industry that I would argue rivals the Congress for unpopularity among the American public. For Republicans according to their own political consultants, the challenge they face or the question that they will face is as follows. If you like the financial institutions that brought you the S&L crisis or that are endangering your pensions, you'll love the private insurance approach to health care reform.

You can decide in your own gut which you think is a more persuasive critique. But sadly, when we try to assess politically which way this debate is going, it comes down to a question as to which institution Americans distrust least, the government or the insurance industry. This is a sad, but I think, accurate commentary on where we are today in the politics of reform. And I think that the answer will have as much to do with the appeal or effectiveness of the political candidates who are selling one or the other of those strategies, as it does with their substance.

That's the debate on the broadest level, but that's not the only place to look for the potential for reform. When we talk about the prospects for reform, we also have to look beyond the rhetoric at what's happening substantively as well. Here I think there is some reason for optimism that we will see reform sometime in the reasonably near future. One area of potential action in the relatively near future has to do with insurance reform, particularly in the small group market. I've mentioned it several times. I wouldn't be surprised if Congressman Rostenkowski mentioned it as well. As you can tell from my remarks, both Republicans and Democrats agree that reform in this industry is critical. And in both parties there are those who would argue, "Let's start where we agree, get these reforms going, and move on from there." Many argue that that is the best way to move the debate beyond the paralysis with which we've become so familiar. So you may see some movement there in the relatively near future, but I would caution you and others that there are some risks to that approach. The risks are in that enacting some of these reforms in a market in which not everyone has to buy insurance will pose some substantial problems of adverse selection, some substantial redistribution of insurance costs among the American public, and would do nothing to slow the rate of increase in health care costs. And there's a risk that if we move forward with these reforms and, as unfortunately almost inevitably is the case, oversell them politically in order to move them forward, we'll have a very disappointed and angry voting public a couple of

years down the road when we will, as we inevitably must, try to do the real job of health care reform. So I'm not sure I'm so comfortable with moving forward in steps.

On the broader scale of more comprehensive reform, I think there is basis for optimism in the fact that the Republicans as well as the Democrats have a meaningful, albeit I'd argue incomplete, reform on the table. Most significant in my view in the Republican proposals, whether it be the President's or Senator Chaffee's, is that they all acknowledge that not only is coverage a real problem and costs a real issue, but also that it will require substantial investment of government dollars to achieve a universal system. And the dollars the Republicans talk about, roughly $36 billion annually estimated for the President's plan, are not so different from the costs of a pay or play approach. No longer, then, can the Republicans say that the Democrats are the only ones talking about costly proposals, making the Democrats afraid to move forward. The Republicans and Democrats are beginning to acknowledge together that there's a need for leadership and public investment to make our health care system work. And I would argue that's the beginning of movement toward political compromise.