Riding the Tiger: Managing Risk in U.S. Housing Finance and Health Insurance Welfare Markets*

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Kimberly J. Morgan
Department of Political Science
George Washington University
Email: kjmorgan@gwu.edu

Alexander Reisenbichler
Department of Political Science
University of Toronto
Email: a.reisenbichler@utoronto.ca

Abstract

This article examines the political and economic dynamics of welfare markets in the United States. These marketplaces differ from other public-private welfare arrangements in that the state crafts and sustains these markets with the aim of using competition to promote cost-effective welfare provision. However, welfare markets face fundamental tensions between competition and stability that we trace to the allocation of risk between the state and private providers. Faced with the prospect of bearing potential losses, private firms either deploy instruments to reduce risk or lobby for risk protections from policy-makers. The result is markets that are either non-competitive but stable, or competitive but unstable. In short, when policymakers create welfare markets they are riding a tiger, making themselves vulnerable to the functioning of markets over which they have imperfect control. We theorize and illustrate these dynamics through analyses of mortgage securitization, Medicare Advantage markets, and the Obamacare health exchanges. This article contributes to the study of the U.S. welfare state, speaks to the perils of marketized welfare in rich democracies, and shows how market reforms can lead to unexpected state expansion.

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Introduction

Market reforms have been on the agendas of rich democracies since the mid-1970s (Vogel 1997, 2018; Landy et. al 2007; Farrell 2018). Markets seem like a powerful antidote to sclerotic public programs and regulations, as competition incentivizes firms to cut costs and improve quality as they pursue profits (Phillipon 2019). Lured by these and other promises, policymakers adopted market reforms in industries from aviation to finance and telecommunications, and also targeted the welfare state (Gingrich 2011; Jacobs and Teles 2007). Instead of fully privatizing public social programs, however, these reforms often resulted in a complicated web of public and private social benefits and services, a phenomenon scholars label the public-private welfare state (Hacker 2002; Morgan and Campbell 2011; Thurston 2018).

We investigate one distinctive element of the public-private welfare state in the United States and other rich democracies: the politics of *welfare markets* (Taylor-Gooby 1999; Nullmeier 2004; LeGrand 2007). Advocates claim that, by harnessing competitive forces, welfare markets can deliver social welfare more cost-effectively than traditional public programs. Welfare markets differ from regular, organic markets in that the state crafts new market structures and products that otherwise would not exist (Vogel 2018). They also differ from other forms of public-private welfare arrangements, such as contracting, because they make private firms compete for customers and profits. Moreover, these markets are deeply political as customers are voters and products are welfare services. Policymakers are loath to entirely leave provision up to these markets, lest voters blame them for failures. The result is a difficult balancing act: promoting sufficiently competitive pressures to yield gains in efficiency and quality without unleashing the destabilizing tendencies of market forces.

Yet, market reforms often yield ambiguous competitive results (Landy et al. 2007). The creation of welfare markets is no exception, as they rarely generate market competition, including

in the examples of Canadian mortgage securitization (Walks 2014), German Riester pensions (Börsch-Supan 2016), or Dutch health care (Maarse, Jeurissen and Ruwaard 2016). And if they do, the destabilizing tendencies of competition can threaten stable welfare provision, as our case studies in U.S. health care and housing finance will demonstrate. In explaining these mixed results, some privilege the regulatory complexity of creating markets, politicians' cognitive limits and ideological biases, or unanticipated firm behavior (Landy et al. 2007). Others emphasize political compromises between the left and right in the context of existing welfare state structures (Gingrich 2011) or information asymmetries inherent in welfare markets (Barr 2020).

We argue that welfare markets exhibit fundamental tensions between competition and stable welfare provision stemming from the allocation of risk between government and welfare providers. In traditional social insurance programs, the state bears risk and covers costs by broadly sharing those burdens. In welfare markets, competition requires private risk-bearing to incentivize firms to improve quality and cost-effectiveness through the threat of revenue losses. Yet, when providers face risk they will engage in actions that can undermine the functioning of competitive marketplaces. Confronted with the risk of bearing potential losses, some providers will exit markets or avoid covering costly risks through adverse selection. Others may turn to sophisticated financial instruments that contribute to market dynamism but also instabilities. In the political realm, firms can exploit the dependence of policymakers on their participation in markets as a source of leverage to procure greater subsidies or other risk-cushions. Together, these dynamics create and reproduce markets that tend to be either uncompetitive but stable, with firms enjoying rent-seeking positions, or competitive but unstable, with private actors exiting markets or engaging in aggressive profit-seeking. In short, policymakers are riding a tiger, as they make themselves vulnerable to the functioning of markets over which they have imperfect control.

This article examines the politics of welfare markets in two areas of the U.S. welfare state – health insurance and housing finance. In both domains, policymakers created welfare markets where none existed previously but have struggled to balance competition and stable welfare provision. In health insurance, we examine the private Medicare Advantage (MA) plans that were set up to compete for the business of Medicare beneficiaries as well as the Affordable Care Act's (ACA) insurance marketplaces. In housing, policymakers intended to create a competitive market for mortgage securitization – where mortgages are pooled and sold as mortgage-backed securities -- in order to provide affordable mortgages. All three cases illustrate the built-in tensions between competition and stable welfare provision, particularly how increased competition can lead to market and welfare destabilization.

These findings improve our understanding of welfare state marketization. Scholars have shown how market reforms can lead to an *expanded* role of the state (Krippner 2005; Farrell 2018; Quinn 2019; Hibou 2004; Vogel 1997; Jacobs and Teles 2007; Zysman and Breznitz 2012). We concur by drawing attention to how intentionally created competitive marketplaces often destabilize welfare provision and then require government intervention. Making sense of this paradox calls for studying the maneuvers of welfare providers when confronted with risk and competition. A second, related contribution is to bring the question of how firms respond to risk more centrally into analyses of the public-private welfare state (Morgan and Campbell 2011; Thurston 2018; Hacker 2002) and welfare markets (Taylor-Gooby 1999; Nullmeier 2004; LeGrand 2007). Existing work reveals how welfare systems influence the individual experience of risk (Hacker 2019; Mares 2003; Rehm 2016; Iversen 2005). We turn attention to how structuring welfare markets involves consequential decisions about how much risk welfare providers bear, inducing firm behavior that can produce unintended consequences. Our U.S. case studies are

cautionary tales for policymakers about the challenges of meshing competition with social welfare provision.

Risk and the Politics of Welfare Markets

In response to the economic challenges and ideological shifts of the post-1970s era, policymakers pursued marketizing reforms, including the privatization of state-owned enterprises, deregulation of industries, and attempts to inject competitive forces into the welfare state (Vogel 1997, 2018; Landy et al. 2007; Farrell 2018). These reforms reflect an array of forces, including budgetary pressures (Quinn 2019), political ideology and party interests (Gingrich 2011), industry pressure (Starr and Esping-Andersen 1977; Hacker 2002), and the drive to improve welfare efficiency (LeGrand 2007; Osborne and Gaebler 1992). Underpinning many of these motivations are assumptions about the superiority of markets over government. One claim concerns the existential pressures of operating in a competitive market: faced with the threat of extinction, firms should hustle for customers by cutting costs and/or improving the quality of their product, while also improving the choices of users (LeGrand 2007). Another concerns the problem of capture: critics of public programs often argue that the lobbying of organized interests impedes sound government decision-making (Tullock, Seldon and Brady 2002: 45-47). For market advocates, competitive reforms should generate higher quality provision at lower cost while minimizing rent-seeking (Olson 1981; Cannon and Tanner 2005; Landy and Levin 2007: 9).

Similar ideas have driven reforms that led to the development of “welfare markets” in which social benefits or services are delivered through market mechanisms but with extensive government involvement (Taylor-Gooby 1999; LeGrand 2007; Nullmeier 2004). It is true that the state sustains all market activity, but the role of the state is particularly crucial in structuring welfare markets, where it crafts, constitutes, and reproduces a marketplace that otherwise would not exist, providing the “glue” that holds it together (Vogel 2018; Fligstein 2001; Quinn 2019; Saltman and

Von Otter 1993: 17-18). Welfare markets are therefore akin to what Vogel (2018: 38) calls "fabricated markets," which are

> characterized by deliberate planning of market design, a specific moment of market launch, and/or the creation of a product and a market that would not exist in the absence of conscious design. Laissez faire in these cases would mean no market at all.

Beyond these qualities, welfare marketplaces are unique in that customers are voters, products are welfare services, and politicians are principals judged by voters on the performance of these markets. This not only sets welfare marketplaces apart from regular or organic markets, where firms sell products to consumers who are free to decide whether or not to buy these products, but it also raises the political stakes around their functioning.

Welfare markets are distinct subsets of the public-private welfare systems found in many rich democracies, especially the United States (Hacker 2002; Howard 2007; Morgan and Campbell 2011; Adema, Fron and Ladaique 2011). Public-private welfare systems include traditional contracting, in which providers deliver benefits or services but without much competition for customers and profits. Tax subsidies for employer-provided benefits or individual welfare purchases, such as the mortgage interest deduction, also differ from welfare markets as we define them, because the state did not actively design or launch competitive marketplaces in these instances (Berner, Leisering and Buhr 2009). While some of the literature on welfare markets conflates these different arrangements (Le Grand 2007; Taylor-Gooby 1999), we focus on state-designed welfare markets to investigate cases in which policymakers attempt to improve welfare provision through the creation of competitive markets.

In the United States, welfare markets cover major social needs. In housing, policymakers set up marketplaces to securitize mortgages -- through government-sponsored, privately-operated enterprises -- that encourage bank lending and thereby improve households' access to housing loans and homeownership (Schwartz 2012; Schelkle 2012). In education, they created a

securitization market for student loans by tasking the government-sponsored, for-profit enterprise with buying and selling student loans as a way to expand access to education (Corder and Hoffmann 2004). While the student loan securitization market was fully privatized in the 2000s, the former government-sponsored agency, Sallie Mae, still dominates it. In health insurance, subsidized private insurance plans compete for the business of beneficiaries in MA -- the option for Medicare beneficiaries to receive their benefits through private insurers -- and Medicare part D drug coverage, some state-level Medicaid managed care programs, and the ACA health insurance exchanges. In all these examples, policymakers consciously designed and legislated welfare marketplaces, which gave birth to new markets, profit-making opportunities, and products where none existed before.

Welfare markets are also present in many other rich democracies. In Canada, policymakers created welfare markets to securitize mortgages -- yet through a fully public agency, the Canadian Mortgage and Housing Corporation (CMHC) -- to encourage affordable mortgages (Walks 2014). In Germany, the 2001 Riester pension reform gave rise to a welfare market in which households could invest in subsidized, supplemental private pension products offered by firms in financial markets (Berner, Leisering and Buhr, 2009; Nullmeier, 2004). Employment rehabilitation services have been marketized in countries such as Denmark, Germany, the Netherlands, and the United Kingdom (Greer et al. 2018). And a number of European countries reformed health insurance systems in ways akin to the ACA (Thomson et al. 2013). In the Netherlands, for example, a 2006 health reform has mandated and subsidized individuals to buy health insurance from a market of competing plans (Maarse, Jeurissen and Ruwaard 2016). In sum, welfare markets "have become a dominant reform trend which can be observed throughout all welfare regimes and in different social policy fields" (Klenk and Nullmeier 2010: 33).

However, efforts to reap the benefits of market reforms and competition have often run aground. Most commonly, welfare markets are stable yet lacking in competition. In the cases of housing finance in the United States and Canada today, there is almost no private competition

within mortgage securitization markets, as public or quasi-public agencies dominate these marketplaces. The German Riester pension markets, similarly, did not generate the envisioned competition on cost and quality among providers, owing to high and opaque costs for consumers (Börsch-Supan et al. 2016). Competition in the Dutch health insurance system is highly managed: extensive regulations and subsidies limit competition, as does the high degree of consolidation among insurers (Maarse, Jeurissen and Ruwaard 2016). At the other extreme are welfare markets in which intense competition proves destabilizing or generates outcomes contrary to the goals of welfare provision. The marketization of employment rehabilitation services, for instance, has led to widespread problems of adverse selection ("creaming and parking"), as private agencies prioritize assistance to those deemed most likely to find employment, neglecting cases most in need of support (Greer et al. 2018). As our case studies show, U.S. policymakers struggled to stabilize the ACA's health insurance exchanges, experienced similar turmoil with Medicare Advantage markets in the early 2000s, and witnessed destructive instabilities in mortgage securitization in the run-up to the financial crisis of 2008-09.

Existing explanations for these failures emphasize how complexity, cognitive constraints, and partisan compromises limit policymakers' ability to construct workable welfare markets. Politicians face high degrees of complexity and uncertainty owing to imperfect and asymmetric information about price and quality of welfare goods and services (Barr 2020, ch. 3). These conditions limit their abilities to design marketplaces with predictable interactions between consumers and providers that also fulfill the intended social objectives (Landy et al. 2007; Phillipon 2019: 4). In addition, policymakers often resort to cognitive shortcuts rooted in ideology and confirmation bias when creating markets, increasing the likelihood of undesired consequences (Jacobs and Teles 2007). Finally, Gingrich (2011) shows that market reforms result from left-right compromises. That markets might not work could thus reflect the multiple motivations that shape these reforms (Barr 2020: 59).

Although we agree that these forces can undermine marketizing reforms, we argue that a more fundamental problem stems from the treatment and management of risk. By risk, we mean the prospects of bearing potential losses (i.e., the chance that actual returns differ from expected returns). In contrast to the existing welfare state literature, which tends to focus on whether social programs cushion individuals from risk (Baldwin 1990; Mares 2003; Iversen 2005; Rehm 2016; Hacker 2019), we focus on providers as risk-bearers, as their decisions on whether and how to enter and remain in welfare markets are crucial to their existence and effects. This focus sheds light on economic and political dynamics that reflect the distribution of risk between government and these providers.

Creating welfare markets entails decisions about how much government and market providers will bear risk. In fully public programs, the government is the primary bearer of risk and thus responsible for cost-overruns or revenue shortfalls (Moss 2002). Advocates of marketized private programs seek to move some risk onto private actors because, when firms risk losing customers or profits, they should act to deliver higher-quality products at lower cost (Morgan and Campbell 2011: 87). Yet, risk is a hot potato, generating economic and/or political responses by firms seeking to limit their exposure to risk. These actions -- policy feedback effects that operate through providers (Pierson 1993; Mettler and SoRelle 2017) -- and the responses of policymakers to them tend to undermine competitive welfare markets.

Providers' economic actions hinge on how risk operates in particular markets. In financial markets, economic agents face "credit risk" -- the possibility that lenders or investors will not be repaid the principal and interest on their loans or investments (Green and Wachter 2005; Wachter 2019).[1] Yet, financial actors often believe they can manage these risks through sophisticated

[1] Investors also face market risks, such as prepayment and interest-rate risks. Homeowners may pay off mortgages prematurely before investors could turn a profit. When interest rates rise, investors can make more money investing in other assets. Related to the latter are maturity mismatches on banks' balance sheets, such as lending long-term mortgages and borrowing short-term deposits from savers, as long-term interest rates charged for mortgages might not match those paid out to depositors (Schwartz 2012; Boleat 1985).

financial instruments (Goldstein and Fligstein 2017). One is mortgage-backed securities that pool mortgages, set underwriting standards for mortgages, divide up these securities in different tranches of risk to be sold to investors in portions, or offer investors guaranteed principal and interest payments in exchange for a fee to cover potential losses. The belief that risk can be managed makes financial markets prone to risk-taking. The financial community not only celebrates such actions, but also often pressures market agents to engage in aggressive opportunism in a competitive race for profits (Abolafia 1996; Nelson and Katzenstein 2014; Tett 2019).

Providers face different risks in health insurance markets, where problems of asymmetric information are particularly pronounced. As individuals usually have better guesses about their prospective healthcare needs than insurers, the latter face difficulties in pricing risk (Arrow 1996: 110-11; Barr 2020). Insurance companies therefore try to select healthy patients over those they expect will be less healthy to minimize losses and maximize profits. There are similar adverse selection dynamics in marketized employment services (e.g., job training and welfare-to-work). When private job centers are paid based on their success in placements and thus bear the risk of potential financial losses, they select people they believe are the best candidates for rehabilitation while neglecting others (Bredgaard and Larsen 2008: 347).

Making firms bear risk generates economic and political behaviors by providers that undermine welfare markets. In the economic sphere, firms may exit the marketplace or else devise ways to reduce risk. Private actors in housing finance might embrace competition and manage risk with the help of financial instruments; however, if risk is mispriced, these actions can destabilize markets (Wachter 2019). Their counterparts in healthcare try to drop potentially expensive customers, and if prevented from doing so, could exit the market or engage in other maneuvers that erode coverage. In the political realm, providers often become “nasty rent-seekers,” actions that can stifle competition (Landy et al. 2007; Phillipon 2019; Osborne and Gaebler 1992: 106). Their lobbying efforts for government cushions, such as subsidies and/or

protected market share, frequently succeed due to information and resource asymmetries between firms and public officials (Barr 2020) as well as pantouflage (Farrell 2018). Moreover, firms in these marketplaces tend to have structural power (Culpepper 2015), owing to the dependence of policymakers on the functioning of these marketplaces in meeting their political objectives. This is what makes these private actors so powerful. Policymakers find themselves in what Zysman and Breznitz (2012) call a "double-bind" of trying to unleash competitive forces while simultaneously having to correct market dysfunctions to avoid collapse, all while depending on the expertise, information, resources, and cooperation of market agents.

In short, policymakers are riding a tiger when yoking social welfare goals to competitive market forces. When private firms maneuver in response to risk and profit-making potential, markets evolve in ways that alter their form, nature, or function. The resulting political dynamics reinforce either non-competitive and stable marketplaces with few market participants who enjoy rent-seeking market positions, or competitive and unstable ones with private actors exiting markets or engaging in aggressive profit-seeking. Involving private actors can elicit rent-seeking or aggressive market behavior, undermining the original objectives of these markets and weakening policymakers' capacity to formulate social policy.

We illustrate these dynamics in two different areas of the U.S. welfare state, housing and healthcare, where their respective treatment and management of risk generates similar tensions between stability and competition. As noted earlier, European welfare markets tend to be highly regulated and subsidized, thus limiting the degree of competition in favor of stability. We examine U.S. welfare markets in housing and healthcare to demonstrate an additional dynamic -- that competition can lead to market and welfare destabilization. Our U.S. case studies should be a cautionary tale for market advocates promoting competitive structures and private risk-bearing in the welfare markets of other rich democracies.

Health Insurance

Across OECD countries, neo-liberal prescriptions have influenced reforms of health care provision and insurance (Lynch 2020). Such ideas are especially powerful in the United States, where policymakers have attempted to constitute new health insurance markets as a way to expand access to insurance. Stimulating competitive pressures is central to this vision: market advocates argue that as insurance companies strive for profits, they will innovate and cut costs (Butler and Moffit 1995; Cannon and Tanner 2005). In reality, these markets have been plagued by two difficulties: the tendency of insurance companies to shed costly risks, thereby undermining the objective of making insurance widely available; and the fact that these marketplaces give insurers power to demand greater subsidies or other favorable treatment. In response, policy-makers have adopted measures that undercut competitive forces, reinforcing a situation of rent-seeking on the part of insurers. MA and the ACA markets illustrate the clash between stimulating competition and providing social protection.

Medicare Advantage

Free market advocates have long made Medicare, the federal health insurance program for senior citizens and the permanently disabled, the object of competitive reforms (Oberlander 2003, ch. 7). Over several decades, policymakers created a market of private insurance plans that is supposed to compete for beneficiaries. Aiming to provide better care at a lower cost, policymakers initially sought to put enough risk upon private plans to stimulate competitive pressures. In practice, risk-cushioning subsidies have been essential to this market, and private insurers threaten market exit to procure and maintain these protections. MA is therefore stable, sustained by private insurers and a growing number of Medicare beneficiaries who rely upon it. However, MA reveals the difficulty of developing competitive welfare marketplaces, as the program's insurance plans rely on excessive public payments and other maneuvers shielding them from risk. The higher payments are not passed through to beneficiaries as reduced cost-sharing or

more benefits; instead, plans absorb a sizable portion of these payments as profits (Duggan et al. 2016).

The MA program grew out of efforts to cut federal Medicare spending and improve the quality of care by making health insurers bear more risk for their beneficiaries' costs (CRS 2009; GAO 1997). Critics argued Medicare used an outdated fee-for-service payment model whereby the federal government reimburses care providers. Replacing this model with one in which private insurance plans compete for beneficiaries and bear some risk for their costs would stimulate market forces and bring managed care techniques (coordinating care and controlling costs) into Medicare. After allowing private managed care plans to contract with Medicare and compete to deliver benefits, a 1982 budget law created risk contracts, whereby Medicare paid private insurers flat-rate payments at 95% of the cost of regular (fee-for-service) Medicare, plus an adjustment for the risk profile of each plan's beneficiary pool. In making plans bear risk for beneficiaries' expenses, one goal was to incentivize private insurers to coordinate care, reduce excess use, and improve beneficiaries' health. Plans could keep some of the savings as profits, which could be used to improve the health plan and compete for more beneficiaries. The proportion of beneficiaries choosing private plans over conventional Medicare expanded markedly, reaching 14% by 1997.

Private plan growth partly stemmed from a flourishing market of health maintenance organizations (HMOs) (Kelly 2013), but it also emerged as insurers found ways to avoid covering costly individuals. People who signed up for these plans were healthier than those in traditional Medicare, but private insurers also discouraged potentially sicker beneficiaries from signing up for their plans (Biles et al. 2004). Risk adjustment should have modified payments according to the health of the beneficiary pool, but it was based on simple demographic factors. Even though the government paid these plans less, per beneficiary, than fee-for-service Medicare, the government spent more on Medicare than in the absence of these private plans.

The congressional response was to cut payments in order to stimulate competitive pressures on private insurers. The 1997 Balanced Budget Act replaced risk contracts with the Medicare+Choice program, expanded the types of plans that could participate in the program, introduced health-based risk adjusting that reduced (without eliminating) excess payments, and limited payment rate increases. In shrinking the cushion for these plans, the aim was to make them bear more risk. As the GOP congressional majority ultimately aimed to replace Medicare with a system of competing private plans, they hoped Medicare+Choice would demonstrate the virtues of competition by delivering better care at lower cost (McGuire et al. 2011: 308).

Private insurers used lobbying and threat of marketplace exit to combat these changes. Plans exited Medicare in droves: between 1999 and 2003, more than 2 million beneficiaries lost their plans (McGuire, Newhouse and Sinaiko 2011: 310). Angry beneficiaries pressured policy-makers to act (McGuire et al. 2011: 309) and health insurance lobbyists used beneficiaries' complaints as evidence for why generous payments should be restored. The insurance industry also deployed considerable financial resources in campaign contributions and lobbying. Between 1998 and 2004, campaign spending by health services/HMOs increased from over $2.9 million to nearly $6.4 million, while spending on lobbying doubled.[2] The push to restore subsidies was aided by the fact that many Choice beneficiaries lived in Democratic areas, impelling a bipartisan push to shore up the program (Kelly 2013).

Faced with industry pressure and angry beneficiaries, in 2003 the Republican majority in Congress turned Medicare+Choice into Medicare Advantage, restored its generous payments, and improved risk adjustment with the stated purpose of restraining program spending. Instead, average plan payments increased by 10.9%, with some plans receiving increases of as much as 40% (McGuire et al. 2011: 314). MA costs swelled beyond those of traditional Medicare, and spending reached a high point of, on average, 114% of the cost of fee-for-service Medicare in

[2] https://www.opensecrets.org/industries/summary.php?ind=H03&recipdetail=A&sortorder=U&cycle=All (accessed October 19, 2020).

2009 (Society of Actuaries 2015). As plans used managed care techniques to lower health spending on beneficiaries, they reaped considerable profits. An NBER study of 2010 data found that MA insurer revenues were 30% higher than their spending (Curto et al. 2017). The proportion of Medicare beneficiaries in private plans grew from 11% in 2003 to 23% in 2009.

To pay for its own health care reform, the Obama administration attempted to cut program spending by changing how insurance plan rates would be calculated. But the administration then instituted mechanisms compensating for these cuts, reflecting industry lobbying (Kelly 2013) and a desire to soothe the insurers on which the administration depended for implementation of the ACA (Demko 2014b).[3] The Obama administration also regularly yielded to intense lobbying around MA reimbursement rates. Each year, the Department of Health and Human Services (HHS) announces proposed rate increases and faces furious lobbying by insurers who issue dire warnings about how inadequate rate increases will harm beneficiaries. Usually, HHS relents: in April 2013, HHS abandoned a proposed 2.2% rate cut for 2014 in the face of "an intense lobbying campaign by the insurance industry that involved white papers, television ads, grassroots organization, and a series of bipartisan letters from more than 160 members of Congress" (Sanger-Katz 2013). The HHS gave in to these pressures and instituted a 3% rate increase. Similarly, in 2014, health insurers asserted that, if the administration reduced reimbursement rates for 2015, the result would be increased premiums and copays for beneficiaries, as well as lower benefits, all of which would harm Medicare beneficiaries (Demko 2014a). Instead of a proposed 2.3% cut in rates, HHS allowed a 3.3% increase.[4]

The Trump administration has behaved similarly: a proposed rate increase of 1.84% for 2019 grew to 3.4%, following industry lobbying. Behind these claims is the Coalition for Medicare Choices, a group that an insurance industry trade association created to fight MA reimbursement

[3] The administration created quality bonus payments to reward good plans and a demonstration project that returned 71% of 2012 MA cuts to plans (Kelly 2013, 340-1).
[4] https://ahsrcm.com/medical-billing-news/cms-increases-medicare-advantage-rates-for-2014/ (accessed October 19, 2020).

cuts.[5] Insurers also aggressively use diagnostic coding practices – maximizing the number of illnesses coded as needing reimbursement – to compensate for reduced payments. (Parente and Feldman 2019). Officially, MA plans receive an average of 101% on what is spent on fee-for-service Medicare, but they actually receive 102-103% when accounting for these practices (MedPac 2018).

In sum, insurers found a way to limit risks and maximize profits. As long as plans can select based on risks, they limit the full force of competition. The MA market is not very competitive: 97% of it is highly concentrated and lacks competition between plans (Biles et al. 2015). These developments parallel those in health insurance markets as a whole, which have become increasingly concentrated (Glied and Altman 2017). Average MA plan margins are a healthy 2.6% overall, with for-profit plan margins averaging 4.9% pre-tax (MedPac 2018). However, this "market" is more about propping up insurance industry profits than it is about harnessing market forces to save money or improve the quality of Medicare.

Obamacare

The ACA healthcare exchanges demonstrate a similar clash between constituting a competitive market and achieving social welfare objectives. The individual insurance marketplaces only exist with substantial government cushioning. Yet, for political reasons, the GOP has fought the law and demanded cuts in subsidies, making insurance plans bear more risk. Such actions undercut the stability of these markets, leading many plans to exit while those that remain often raise premiums. The threat of exit has, however, given private insurers some influence, owing to the political costs of taking away people's health insurance. The resulting tug-of-war has left the exchanges in limbo, with Republicans unable to rally enough support behind destroying these markets, yet also unwilling to support them.

[5] http://medicarechoices.org/seniors-coalition-mobilizes-to-protect-medicare-advantage/ (accessed October 19, 2020).

The ACA sought to expand health insurance coverage through insurance market reform. Individuals and small employers often had difficulty purchasing affordable, decent-quality health insurance. With most people getting insurance through larger employers or federal programs, the remaining risk pools suffered from adverse selection. The result is expensive insurance coverage that further deters healthy people from buying it and exacerbates an unbalanced risk pool. Even those with insurance often faced skimpy coverage – high out-of-pocket costs, lifetime coverage maximums, no coverage for preexisting conditions, and other insurance plan maneuvers to limit exposure to high risks.

The ACA's insurance reform banned many of the latter practices in return for delivering new customers to the industry. Taking a page from the Republican pro-competitive health reform playbook (Quadagno 2014), the ACA created a health insurance marketplace on which people could buy plans. To combat adverse selection, the law mandated that people buy coverage, imposed financial penalties on those who do not, and instituted income-related subsidies to help lower-income people purchase insurance. The law also included three measures to cushion insurers from the risks of participating in ACA exchanges: (1) risk adjustment, a permanent system redistributing costs between plans with a low-risk pool of beneficiaries to those enrolling a higher risk pool; (2) reinsurance, federal payments for the first three years to insurers of patients with high health costs; and (3) risk corridors, a temporary fund to compensate insurers who spend more on care receive while those who spend less pay into the fund.[6]

Because these marketplaces needed insurance plans to participate, insurers gained political leverage over the law's implementation. As in MA, insurers lobbied for the best deal, leading some to call the ACA the "full employment act for K Street" (Serafini and Vaida 2010). Although many insurers opposed the ACA during its legislative crafting, once passed they saw money-making potential in it (DoBias Nov 2010). Insurers therefore had reasons to help the

[6] https://www.kff.org/health-reform/issue-brief/explaining-health-care-reform-risk-adjustment-reinsurance-and-risk-corridors/ (accessed October 19, 2020).

administration get the marketplaces up and running (Catalin 2013) while the Obama administration also was solicitous of their concerns. In spring 2014, for instance, the Administration made changes to reinsurance and risk corridors that expanded insurers' access to these funds. For conservative critics, this was a "slush fund" for the insurance industry (Cost and Anderson 2014). The administration's dependence on the industry to help implement the law also partly explains its willingness to repeatedly raise MA rates (Demko 2014b).

As the insurance industry cozied up to the Democratic administration, Republicans were divided: some wanted to bolster the exchanges to stymie moves for a government-provided alternative, while sought to undermine Obamacare entirely (Jones et al. 2014). Some GOP-controlled state governments refused to expand Medicaid as the law envisioned or set up state-level health insurance exchanges (Béland, Rocco and Waddan 2016). Between 2011 and 2016, Congress voted more than six times to undermine or end the law, with five votes on its complete dismantlement (Peterson 2018: 606). As legislators knew Obama would veto these measures, they were largely symbolic but did stoke concerns among insurers trying to decide whether to enter the marketplaces.

More significant was Sen. Marco Rubio's "quiet legislative sabotage" of the health exchanges (Pear 2015) by seeking to increase competitive pressures on insurance plans. Rubio attacked the ACA's risk corridor mechanism as a boondoggle for insurers and went after the cushions that helped constitute the market, arguing that firms should bear the consequences for failing to make money on these markets. As Rubio said during a Senate debate, "If you want to be involved in the exchanges and you lose money, the American taxpayer should not have to bail you out" (Pear 2015). Consequently, in late 2014, he introduced a measure that barred using general revenues to make risk-corridor payments. According to insurers, this meant they never received $12bn in payments owed to them.

These combined attacks on the ACA stymied enrollment. By not setting up state health care exchanges, a greater burden fell on the federal exchange. The federal marketplaces had a

rocky start, which likely deterred lower-risk people from buying insurance (Herman 2016). The tax penalty for non-insurance also was not tough enough to induce healthier people to sign up. Enrollment was therefore about half of that originally projected. As insurers faced a sicker and costlier risk pool, they pressured policy-makers through political mobilization and market exit. They issued continuous warnings about how monkeying with risk-sharing mechanisms would reduce plan participation in the exchanges or raise premiums (Pear 2015; Durkin 2016). These were credible threats, given the reluctance of some big insurers to enter the marketplaces. Many held back in 2014 and cautiously expanded participation in 2015, figuring that if they failed to grab market share, the stickiness of insurance plan choices would make it hard to enter later (Demko 2014c).

As enrollment in health plans drew fewer and disproportionately sicker people, and the GOP signaled it would not assist struggling insurers, the latter began raising premiums or leaving the markets. Insurers felt Rubio's attack on risk adjustment starting in late 2015, which contributed to the decision of some insurers to drop out. For example, the Health Republic of Oregon folded once it discovered it would receive only a fraction of the risk payments it expected (Pear 2015). Others made dramatic turnabouts in response to worsening market conditions. UnitedHealth Group declared in October 2015 that it expected to stay on the exchanges, but only a month later announced it had lost $1bn on the exchanges and by spring 2016 retreated from most of them (Herman 2016). Aetna also declared in 2016 that it lost over $400 million on the exchanges and would leave most markets (Surowiecki 2016), and was followed later by Humana, which fully quit all ACA markets in 2018.

The remaining plans on the exchanges increased premiums (Goozner 2016) and could so because of declining competition from other plans. Starting in 2016, premiums increased significantly, although this varied by state and county. Premium increases, in turn, led those earning too much to qualify for ACA subsidies to drop their insurance: about 1 million people did just that in 2017 (Sanger-Katz 2018). In 2019, premiums levelled off or declined in some areas,

because some state governments stepped in and created reinsurance programs to replace the federal one, while the huge premium increases of the previous years gave insurers some breathing room (Kirkner 2018).

The upshot is that ACA markets, in contrast to MA, remain in a tenuous situation. Insurers decided not to push to maintain the subsidies that would help keep them in ACA markets (Hacker and Pierson 2018: 564-5). For many big insurers, the ACA exchange business was not of great significance to their bottom line: even as these firms were losing money on the exchanges, they were still very profitable companies with high stock market valuations. Without much at stake, insurers were thus largely silent during efforts by the GOP to repeal the ACA in 2017. Even so, the GOP's failure to repeal the law, despite having full control of Congress and the Presidency, reveals the difficulty of uprooting a system that was delivering health insurance to many. A recent Trump administration effort to throw out the ACA's ban on allowing insurers to refuse coverage or impose higher premiums on people with preexisting conditions fueled a "panic" among Republicans in Congress fearful about the impact on 2018 elections (Ollstein 2018).

Trump officials also sought to both satisfy the Republican base by taking steps to undermine the law, while adopting other measures to stabilize the marketplaces. The administration ended the individual mandate, cut spending on marketing for enrollment, ended risk adjustment spending for insurers, and encouraged a parallel market of cheaper, lower quality insurance plans as alternatives to plans meeting ACA requirements. But in July 2018 the administration also reinstated risk adjustment for plans at the urging of GOP members of Congress fearing chaos in the market that could lead to an electoral slaughter (Pear 2018). As of this writing, the fate of the ACA may lie in the Supreme Court, which will consider whether or not to invalidate the entire statute. What we have already seen, however, is how much government risk-cushioning is needed to sustain these marketplaces.

Housing Finance

Housing finance markets are deeply entwined with the welfare state, fulfilling important social functions of obtaining homeownership (Schelkle 2012; Schwartz 2012; Thurston 2018). Much like welfare markets in health insurance, mortgage securitization displays tensions between stable welfare provision and competition. To ensure access to affordable mortgages, policymakers created the mortgage securitization marketplace in the late 1960s by tasking for-profit GSEs, Fannie Mae and Freddie Mac, with buying mortgages from private banks, pooling these mortgages, and selling them to investors as mortgage-backed securities. While policymakers intended to create a competitive securitization marketplace, in which the GSEs would compete with financial institutions, they crowded out private competition. The situation temporarily changed in the 2000s when financial institutions flocked to the securitization marketplace, producing the competition and private risk-bearing that policymakers originally envisioned. Yet, heightened competition between and among private banks and the GSEs fueled aggressive profit-making behavior and resulted in market collapse in 2008. Policymakers responded by bailing out the battered GSEs while private banks exited the market. Today, the GSEs once again dominate the securitization market and there is little private risk-bearing.

The origins of the mortgage securitization welfare market lie in the liquidity problems of a strained deposit-based mortgage market in the late 1960s and early 1970s. When savers and investors fled the savings and loans (S+L) market as a result of rising inflation and interest rates, the consequence was maturity mismatches and illiquidity in the S+L sector -- that is, these institutions were lending long (e.g., 30-year, fixed-interest mortgages at low rates) but borrowing short (e.g., deposits at rising interest rates) (Schwartz 2012; Boleat 1985). Policymakers then created the securitization market to improve liquidity, counter maturity mismatches, and provide off-budget funding for affordable mortgages (Green and Wachter 2005; Quinn 2019; Immergluck 2009). The practice of mortgage securitization takes mortgages off banks' balance sheets and therefore improves liquidity in housing finance.

Policymakers envisioned a competitive securitization market in which private banks would emulate and compete with mortgage securitization pioneered by the GSEs. In 1968, the Johnson administration authorized Fannie Mae, then already a for-profit GSE, with issuing mortgage-backed securities.[7] In 1970, the Nixon administration created Freddie Mac, another for-profit GSE, to introduce competition with Fannie. Having issued mortgage-backed securities on a large scale only since the early 1980s, the GSEs have guaranteed investors the principal and interest payments from the underlying mortgages in exchange for fees. According to a Congressional report, the rationale was that "if such securities become well enough established so that many private issuers are issuing them, they could constitute a significant factor in attracting investment funds to the field of mortgage investment."[8] In other words, policymakers hoped for competition and private risk-bearing in the securitization market.

Yet, with the GSEs at the center of the securitization market, little competition followed. By the early 1980s, the GSEs' market share only reached 16% of the overall residential mortgage market (figure 1), as the country's mortgage system was still largely deposit-based (Green and Wachter 2005). However, the GSEs' market share *within* the securitization market was close to 90%. Private banks could not compete with the GSEs, as the latter received tax privileges that private banks did not, borrowed more cheaply in capital markets, enjoyed more lenient capital buffers, and faced lower regulatory burdens (Acharya et. al 2011; Koppell 2003). As a result, the U.S. government bore risk for catastrophic losses in the event of large-scale mortgage defaults, which came at the cost of "socializing (credit) risk" in the securitization market (Schelkle 2012: 65-66).

[7] Ginnie Mae, created as a fully public agency in 1968, offers insurance on mortgage-backed securities that consist of federally guaranteed mortgages. Ginnie developed the very first MBS in 1970, while Freddie and Fannie issued their first MBS in 1971 and 1981, respectively. In contrast to Fannie and Freddie, Ginnie neither issues nor holds MBS; it instead insures eligible MBS issued by private lenders.

[8] U.S. House Committee on Banking and Currency, "Report on Housing and Urban Development Act of 1968" (1968).

Early deregulatory attempts to introduce more competition in mortgage securitization failed. In 1984, the Reagan administration adopted the Secondary Mortgage Market Enhancement Act to generate competition, increase liquidity, and prevent further GSE growth (Immergluck 2009: 43). The idea was to broaden "the number of participants channeling investor capital to the homebuyer," creating a "downward impact" on mortgages.[9] While the measure removed restrictions for banks and investors to trade mortgage-backed securities, it did little to promote competition, given the persisting unequal playing field between the GSEs and private banks. To create more competition, the Tax Reform Act of 1986 made trading advanced mortgage-backed securities more attractive for both issuers (i.e., fewer tax restrictions) and investors (i.e., tailored to specific needs) (Fligstein and Goldstein 2012). Yet, it did not increase competition because the GSEs retained their price advantages and crowded out private banks, much to the dismay of investment banks (Koppell 2003: 100).[10]

Until the late 1990s, mortgage securitization took place in a non-competitive yet stable marketplace that gradually replaced the previous deposit-based mortgage system (Green and Wachter 2005) and met the welfare objective of ensuring affordable mortgage debt. It should be noted that white households disproportionately reaped the benefits of this marketplace, as the homeownership rate among nonwhites was much lower, owing to longstanding discrimination in real estate and financial markets, lower parental and family wealth (partly the result of discriminatory federal housing policy of previous decades), and lower median household income (Freund 2007; Thurston 2018; McCabe 2018).[11] Yet, stable welfare provision was not the result of market competition but was produced by the government-supported duopoly of Fannie and

[9] U.S. Senate Committee on Banking, Housing, and Urban Development, "Report on the Secondary Mortgage Market Enhancement Act of 1983," November 2, 1983.

[10] Investment banks led by Salomon Brothers lobbied to prevent Fannie from using these advanced mortgage-backed securities (i.e., issued through special purpose vehicles called real estate mortgage investment conduits). Not only was the lobby attempt unsuccessful, but Fannie flexed muscle and cut off Salomon Brothers from managing the underwriting of these new Fannie securities (Koppell 2003: 100).

[11] In 1990, the homeownership rate among white households was roughly 70%, while that of black and Hispanic households was only around 45%.

Freddie, behind which the U.S. government absorbed risk. Mian and Sufi (2014: 97) note that "as long as GSE securitization dominated the mortgage market, credit risk was kept in check through underwriting standards."

When the securitization market grew in size and importance, so did the influence of the GSEs. By the early 2000s, Fannie and Freddie were two of the largest U.S. companies listed on the New York Stock Exchange. Together with their fully public cousin Ginnie Mae they held or securitized $2.6tn in mortgages, a market share of 43% of the residential mortgage market (figure 1), originating roughly 75% of all mortgage-backed securities (figure 2). In addition to structural market power, their "political firepower was legendary" (Tooze 2018: 47). One source of political power was pantouflage, with a long list of Democrats and Republicans having moved back and forth between public service and the GSEs (McLean 2015).[12] Another was the powerful mortgage and housing industry that supported the GSE-centered housing finance system from which they benefit. As Koppell (2003: 100) notes, "[l]enders, realtors, and other housing-related trade organizations dependent upon Fannie Mae and Freddie Mac for their business can be mobilized to bolster the GSEs' political strength."

In the early 2000s, a confluence of policy actions and economic developments transformed this stable, non-competitive marketplace into one with considerable competition, volatility, and private risk-bearing. In the political realm, first, the decades-long political efforts to liberalize and deregulate the low-quality mortgage market led to a proliferation of unconventional mortgage instruments, such as subprime, jumbo, and Alt-A mortgages in the primary mortgage market (Fligstein and Goldstein 2017; Acharya et al. 2011; Schwartz 2012). Second, in the secondary market, the George H.W. Bush administration started relaxing underwriting standards for GSE securitization with the Federal Financial Safety and Soundness Act in 1992. The reform established a lenient regulator for the GSEs and specified "affordable housing goals" to be met

[12] Opensecrets.org lists 47 high-profile individuals in its revolving door database for Fannie and Freddie. https://www.opensecrets.org/revolving/ (accessed August 21, 2020).

by the GSEs – that is, the GSEs were tasked with securitizing lower-quality mortgages in underserved and low-income communities, relaxing the underwriting standards of the GSEs (Schelkle 2012; Thompson 2012). GSE lobbying, supported by the housing industry, was instrumental in establishing a lenient regulator: a Fannie official stated that the company was "communicating with every member of Congress who we think cares about Fannie Mae and cares about housing and telling them that this bill [with strict regulations] needs to be killed" (Crenshaw 1992). Third, the Clinton and George W. Bush administrations continued pushing the GSEs further into lower-quality mortgages as part of their respective "national homeownership strategy" and "aggressive housing agenda" to produce growth and expand homeownership among minorities. Yet, despite the growing presence of the GSEs in lower-quality mortgage markets, they were still restricted in what mortgages they could securitize and refrained from subprime mortgages. This created an opening for the private market to enter subprime mortgage securitization.

While the untapped opportunity in subprime securitization allowed for private market entry, a confluence of factors explains why private banks moved into it. One set of factors is macroeconomic. Booming housing markets and rising house prices generated investor confidence and demand for housing assets (Immergluck 2009). After watching the GSEs make hefty profits in recent decades, private actors jumped at the opportunity of gaining market share. Investment banks, which had worked closely with the GSEs in developing securitization practices, seized on securitization after the dot-com bubble and Asian financial crisis in search of the "next big thing" (Tooze 2018: 54). Commercial and mortgage banks quickly followed -- acting increasingly like investment banks after the Clinton administration's Financial Services Modernization Act of 1999 allowed them to do so (Schwartz 2012: 51-2) -- as they were under pressure from a low-interest environment. That these private actors moved into risky territory was also influenced by the fact that they were becoming so large that many assumed they were

backed by implicit government guarantees (Acharya et al. 2011; Tooze 2018). As a result, the private subprime securitization market expanded its share in the overall mortgage market from 8% in 2000 to 19% in 2006, while that of the GSEs dropped from 43% to 34% (figure 1). For the first time, in 2005, private banks issued more mortgage-backed securities (i.e., roughly 55%) than the GSEs (figure 2).

Another set of factors was the availability of financial instruments to purportedly minimize risk. Underlying private market entry was the ill-defined assumption that mortgage-backed securities and their derivatives would be able to absorb the credit risk of low-quality mortgages (Wachter 2019). For their part, credit rating agencies reassured investors by giving private-label mortgage-backed securities inflated ratings, often as safe as Fannie and Freddie securities (Thompson 2009). The development and spread of sophisticated derivatives, such as collateralized debt obligations (i.e., re-securitizing existing mortgage-backed securities) and credit default swaps (i.e. insurance against the default of these derivatives), functioned as an equivalent to the risk-absorbing government guarantees behind the GSEs (Fligstein and Goldstein 2012: 351). Investors then bought into the belief that these derivatives were able to manage risk, while these derivatives were still vulnerable to the cash flows of mortgagees. So did federal regulators and central bankers, who were unable to detect and prevent the brewing housing bubble and financial vulnerabilities associated with it (Jacobs and King 2016). As Tett (2019) rightly comments, “[o]ne problem was that derivatives and securitization were so complex that they introduced a brand new risk into the system: ignorance.” In sum, market participants mispriced credit risk in securitization markets, which enabled the housing bubble to build between 2003 and 2007 (Wachter 2019).

As the GSEs came under competitive pressure for securing market share and profits -- reflecting its ambivalent, dual mission of promoting affordable mortgages and maximizing

shareholder returns -- they too started investing in the low-quality, subprime mortgage market (Immergluck 2009). This competitive environment led to aggressive profit-seeking activities between and among the GSEs and private banks (Nelson and Katzenstein 2014), generating a "race to the bottom" (Acharya et al. 2011, ch. 3). These pressures were especially acute when the market for conventional mortgages was saturated by the mid-2000s – partly because interest rate hikes put an end to the mortgage-refinancing boom (Fligstein and Goldstein 2012) – and private actors and the GSEs looked to originate and securitize low-quality mortgages to satisfy investor appetite (Goldstein and Fligstein 2017).

In the 2000s, the Bush administration became concerned about the growing financial risks of the GSEs borne by the U.S. government, yet was unable to push through reform to tighten regulations. From 2003-2005, it proposed the creation of a new regulator for the GSEs, citing concerns about their growing portfolios, opaque accounting practices, and lack of proper regulation (McLean 2015). In the words of Sen. John McCain (R-AZ) in 2006, "[i]f Congress does not act, American taxpayers will continue to be exposed to the enormous risk that Fannie Mae and Freddie Mac pose to the housing market, the overall financial system, and the economy as a whole" (Cited in: Thompson 2009: 20). However, Congressional Democrats and housing interest groups, such as the homebuilders, opposed the proposal, fearing that the GSEs would be forced to scale back their affordable housing activities, which would hurt housing growth and the expansion of homeownership in underserved communities (Thompson 2012). Fannie and Freddie then "began lobbying ferociously to divide Republicans over the issue" (Thompson 2009: 20), and spent a total of $164m on lobbying between 1999 and 2008 (FCIC 2011: xxvi). One GSE regulator testified to the Financial Crisis Inquiry Commission that, during his tenure from 1999 to 2005, the "Fannie and Freddie political machine resisted any meaningful regulation using highly improper

tactics" and that regulators were "constantly subjected to malicious political attacks and efforts of intimidation" (FCIC 2011: 42). The reform efforts failed.

The unintended consequence of heightened competition was the destabilization of the securitization market and then the entire financial system in 2008-09 (Schwartz 2009). When millions of homeowners started defaulting on their mortgage payments -- black and minority households were hit particularly hard, as they were more likely to hold subprime loans (McCabe 2018) -- these payments could no longer be passed on to investors of mortgage-backed securities and collateralized debt obligations. The GSEs and many financial institutions that guaranteed or insured these payments were completely exposed to credit risk and faced bankruptcy.

The importance of the securitization market – which supplies households with mortgages, contributes to economic growth, and affects industries and investors at home and abroad – induced policymakers to quasi-nationalize the securitization market (Thompson 2012). There was widespread political agreement to bail out the battered GSEs at a cost of $191bn, as they were considered "too big to fail" (Acharya et al. 2011). The housing lobby of realtors, mortgage bankers, and homebuilders supported the bailout to restore the housing finance market. The Bush administration quasi-nationalized the GSEs in 2008, giving them a duopoly in the securitization market as private firms exited it due to perceptions of heightened risk. Once again, the U.S. government is bearing risk, currently guaranteeing $7tn in GSE debt and originating more than 90% of all mortgage-backed securities. Regulators already sounded the alarm about protecting taxpayers from GSE credit risk and worked with the GSEs to implement some risk transfer programs to the private market (Wachter 2019). Housing finance reform stalled during the Obama and Trump administrations, as policymakers could not agree on the precise role of the U.S. government in the securitization market. Today, the quasi-nationalized nature of the housing finance market means that the U.S. government and taxpayers, through the GSEs, are bearing the risk of most mortgages in the country.

Conclusion

In rich democracies, policymakers often trumpet the superiority of private markets over public action, and the attendant need to limit the role of the state. These beliefs have driven the creation of welfare markets as part of the public-private welfare state. However, our case studies of U.S. health insurance and housing finance marketplaces reveal the difficulties of reconciling tensions between competitive forces and stable welfare provision. We argue that the treatment of risk produces these tensions. It is difficult to predict how firms respond to risk in these marketplaces, such as through market exit, rent-seeking, or aggressive profit-seeking. When policymakers create these marketplaces in which private firms are central to providing social welfare, they make themselves vulnerable to market dynamics over which they have limited control.

This analysis contributes to our understanding of why market reforms often result in a larger state footprint. Many scholars have shown that market liberalization, financialization, and privatization can result less in a retreat of the state than its reconfiguration and expansion. In the words of Jacobs and Teles (2007: 158), "a market-making project may, paradoxically, culminate in an expansion of state activity that equals (or even exceeds) its initial retreat." In welfare markets, we identify a new mechanism through which this occurs by tracing the behaviors of private welfare providers when confronted with risk. The resulting instabilities and/or scrabble for government protections by providers generates strong pressures for increased state involvement in these markets. In housing finance, excessive competition and market instability led policymakers to bail out the for-profit GSEs, Fannie Mae and Freddie Mac, in essence "socializing" the country's multi-trillion-dollar securitization market. Health insurers are only willing to participate in the ACA and Medicare Advantage markets when guaranteed sufficient subsidies and other risk-cushioning schemes.

A second contribution is to place firms' responses to risk more centrally in the study of public-private welfare systems and welfare markets. Existing scholarship convincingly illustrates

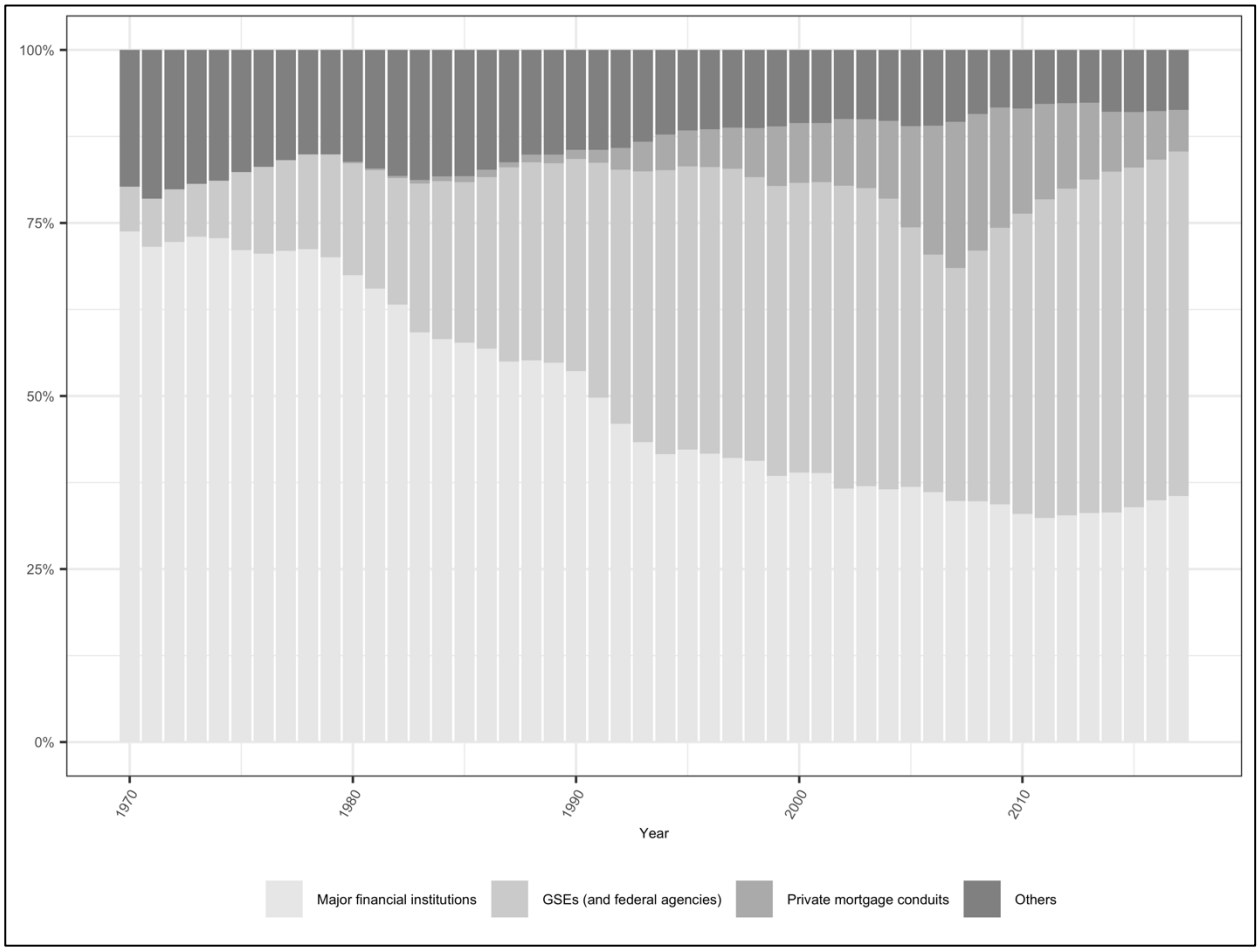
how welfare systems shape the individual experience of risk. We complement these studies by emphasizing an additional and related dimension of risk -- that is, how welfare providers respond to the risk of bearing losses in welfare markets, behaviors that not only produce tensions between welfare stability and market competition but also ultimately threaten the adequate provision of households' social security. Studying how firms respond to risk therefore contributes to a refined understanding of the public-private welfare state.

Although our analysis focused on U.S. welfare markets, we believe that the tensions between market competition and stable welfare provision can be found in other countries. For instance, the Dutch and Swiss health insurance systems are often held up as models of "managed competition" for the United States. But in these systems insurers are shielded from risk through extensive subsidies and government regulation (Okma and Crivelli 2013), while still engaging in selection. Behind the facade of market stability lie practices that undercut competition based on quality and price (van de Ven et al. 2015). The same holds for marketized job training systems in many countries, such as Denmark, Germany, or the United Kingdom, where firms engage in adverse selection to screen out difficult clients (Greer et al. 2018). If blocked from engaging in these practices and thus forced to bear risk for successful placements, we expect this would lead to firms exiting markets or lobbying for greater subsidies, using the threat of the former to help support the latter. Similarly, the Canadian mortgage securitization market is often praised for its stability, including during the financial crisis of 2008-09. Yet, the CMHC, a government agency underwriting mortgage debt, dominates the securitization market while private firms largely stayed away from it to avoid bearing risk (Walks 2014). Future research might further explore the tensions between competition and stability in these and other welfare markets.

Our U.S. case studies are cautionary tales about the destabilizing effects of competitive forces. The resulting market instability can not only lead to costly state involvement correcting for market dysfunctions but also affect the wellbeing and livelihood of households. Decision-makers who prefer to delegate responsibility for social welfare to private actors should be clear-eyed

about the perils of injecting competitive forces into the welfare state. To avoid market instability and costly market corrections, they might instead opt for constraining unfettered market activity through tighter market regulation (Vogel 2018), traditional public social insurance programs (Stone 1993), or well-specified contracting relationships, so as to ensure adequate social welfare for households and avoid instances of privatizing gains and socializing losses for private firms.

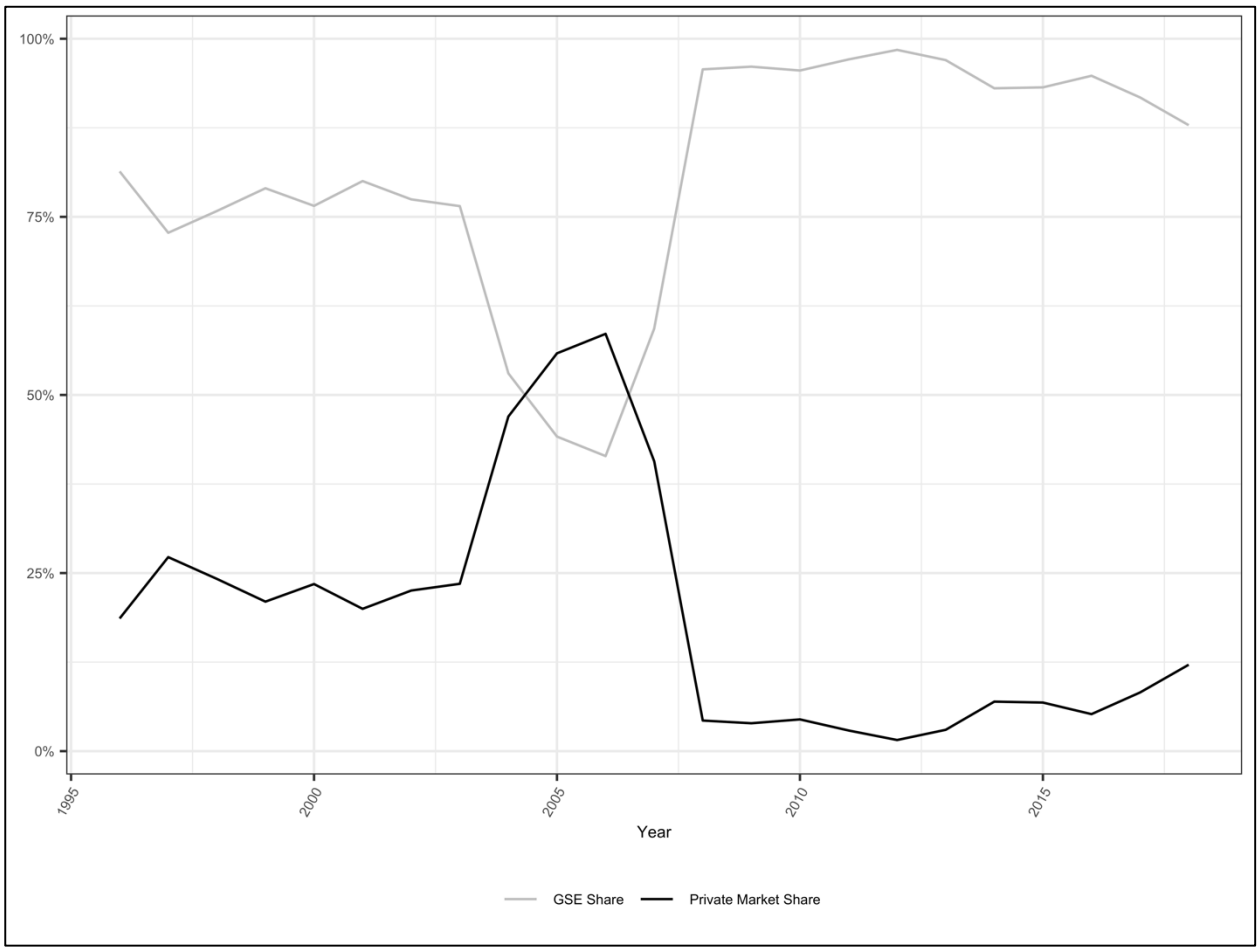
Figure 1. Sources of Mortgage Funding, 1970-2017.



Source: Federal Reserve Flow of Funds.

Notes: Major financial institutions include depository institutions and life insurance companies. Private mortgage conduits are financial entities involved in private-label securitization. GSEs and federal agencies are agencies involved in securitization, including Fannie Mae, Freddie Mac, and Ginnie Mae.

Figure 2. Issuance of mortgage-backed-securities, 1996-2018.



Source: Securities Industry and Financial Markets Association.

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