BARRON'S

Health Act's Dismal Economics

By: Gene Epstein **June 30, 2012**

Let the games begin—or rather, let the gaming of the system begin now that the Supreme Court has upheld the law that mandates the purchase of health insurance under the Patient Protection and Affordable Care Act. Other laws have yet to be heard from, including the laws of economics.

As Manhattan Institute fellow Avik Roy points out, the reason the Act has to mandate that health insurance be bought by individuals lies in the economics of market pricing.

In a properly functioning market for health insurance, young people would normally pay lower premiums than older people, based on very different probabilities of needing medical care. But under the Affordable Care Act, the young are being asked to subsidize the old, with premiums lowered for the latter and hiked for the former. Hence the need for arm-twisting in the form of an individual mandate.

Whatever teeth that mandate will really possess depends greatly on the mix of incentives. Since the Act requires that no one be denied insurance based on preexisting conditions, there already will be no incentive to buy insurance in advance of any need to use it; once you need medical care, you simply buy in as though you were a customer right from the start.

That strategy wouldn't be very popular if the financial penalty for not buying insurance approached the cost of that insurance. But the penalties are far lower, starting at $95 or 1% of annual income in 2014, whichever is greater, and rising to $695 and 2.5% by 2016. By contrast, annual insurance costs would be about $5,000, at least. And at an assumed $50,000 a year income, pretty good for most people under 35, that 2.5% still comes to just $1,250.

Then there's the incentive, or lack thereof, to pay the penalty. Refusing to do so won't be a crime. The collector will be the Internal Revenue Service, which won't even have the power to dun you for the funds via the usual liens and levies. So far, it has declared only that it will have the right to keep sums it would be returning from normal tax refunds.

Since many of us are often over-withheld—fond of that little check the IRS cuts to us every spring—this would seem to be an effective strategy. But then again, once people find the check isn't forthcoming, they may alter their filing status and prevent such over-withholding.

In any case, jobs will be created as a result; the IRS is expected to hire more than 10,000 enforcers of this new provision. That will help because another kind of mandate could hurt job

creation: the employer mandate, which will require firms to buy health insurance for their employees or pay a penalty. But this mandate will apply only to firms with 50 employees or more. That in turn will provide a powerful incentive to firms just below that threshold to stay below that threshold, thus hurting job creation.

Some might object that all omelets, good or bad, require the breaking of eggs. Granting that the Affordable Care Act involves some dismal economics, what is the alternative to providing affordable care? For alternatives that would move in the direction of free markets, try the recently published Priceless: Curing the Health-care Crisis, by John C. Goodman. Just for starters, Goodman would "liberate the supply side of the market" by legally permitting nurses and other lower-level personnel to perform a range of services that now require the participation of much scarcer physicians. By increasing the opportunities for these people, we might induce far more supply. That's another law of economics.