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Why Mandated Health Insurance Is Unfair

There's an easier way to solve the 'free-rider' problem.

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Should all Americans be required to have health insurance? ObamaCare said yes, and the issue is now central to the Republican presidential primary. Mitt Romney championed an individual mandate as governor of Massachusetts. Newt Gingrich once backed the idea too, egged on by several conservative think tanks, though he's now opposed. Its constitutionality aside (that'll be decided soon by the Supreme Court), is a mandate a good idea?

The short answer is no. There is nothing that can be achieved with a mandate that can't be better achieved by a carefully designed system of tax subsidies.

The most common case for an individual mandate is the free-rider argument. Imagine a community in which everyone dutifully pays monthly health-insurance premiums, except Joe. Then one day Joe gets sick and finds he cannot pay the full costs of his medical care. So the rest of us chip in and pay for the remainder of Joe's care. The upshot: When he was healthy, Joe got to consume all his income instead of paying premiums, and after he got sick he managed to "free ride" on everyone else's generosity.

Ethically, Joe is getting an undeserved benefit paid for by others, who bear an undeserved cost. Economically, he is imposing an external cost on others. If we let him get away with this, others might emulate his example and the cost for the rest of us could grow.

So is the solution to mandate that everyone have health insurance? On average, people without health insurance consume only about half as much health care as everyone else. Of the amount of care they consume, they pay for about half. Thus the "free ride" for the average uninsured person is about one-fourth of what everyone else spends on health care.

Forcing Joe to buy insurance that pays for the same amount of care everyone else gets would be neither fair nor equitable. To get Joe to pay his own way, we need to take from him an amount of money equal to about one-fourth of the average health-care spending of insured people and either distribute it to everyone else or put it in a fund to pay for the care eventually required by Joe and others like him.

How could that work? Let's say that \$X is the average health-care spending by insured people. One solution would be to make Joe pay a fourth of that in extra taxes each year. Or, we could achieve an equivalent outcome by giving everyone who has insurance a tax break equal to that amount, but deny the break to Joe and everyone else who is uninsured.

This system is not all that different, at least in principle, from our current tax system. For people who get insurance at work, the employer's premium payments escape individual income and payroll taxes. By contrast, families who are uninsured (and therefore receive taxable wages rather than nontaxed health insurance) face a higher tax bill.

So far, so good. But if we want to build on this structure and solve the free-rider problem, there are three fundamental flaws in the current system that need to be corrected.

First, although the subsidy/penalty system seems to be broadly adequate for the middle class, it is far less so for the rest of the population. For upper-middle-income families, the subsidy for employer-provided health insurance approaches 50%; for lower-income families it is as little as 15%. Generally speaking, we are over-subsidizing the health insurance of the wealthy and under-subsidizing it for the poor. A fixed-sum, refundable tax credit—essentially giving everyone the same subsidy—would solve this problem.

Second, our current system makes no connection between penalties and subsidies. The extra taxes paid by the uninsured (since they don't receive nontaxed benefits from their employers) go mostly to Washington, while the uncompensated care is delivered locally. The answer to this problem is to put the unclaimed tax credits in a charity pool to be used in case uninsured patients cannot pay all of their medical bills.

Third, although we subsidize employer-paid insurance—in some cases very generously—there is virtually no subsidy for people who obtain insurance on their own. The answer to this problem is to offer the same tax subsidy to all, regardless of how they obtain their insurance.

Contrast these straightforward solutions with ObamaCare, which imposes undeserved costs and creates undeserved benefits for no morally or economically justifiable reason. Far from solving the fundamental fairness problem posed by free riders, it creates far more inequities than were there before.

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