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The ObamaCare Carnival of Perverse Incentives

By: John Goodman **January 24, 2014**

With fewer glitches to deter them, millions of Americans are now logging on to the ObamaCare health-insurance-exchange websites. When they get there, many are discovering some unpleasant surprises:

The deductibles are higher than what most people are used to, the networks of doctors and hospitals are skimpier (in some cases much skimpier), and lifesaving drugs are often not on the insurers' formularies. Even after the government's income-based subsidies are taken into account, the premiums are often higher than what people previously paid.

Why is this happening? Because the new law gives insurance buyers and sellers perverse incentives to behave in ways that create these problems. Things will only get more out of whack as more and more unhealthy people enter a system designed to be paid for by premiums from healthy people.

Under the Affordable Care Act, the benefits insurers must offer are strictly regulated. The law piles on benefits for which everyone must have coverage, whether they could ever use the benefits or not. At the same time, insurers set their own premiums and choose their own networks of doctors and hospitals.

To keep premiums as low as possible, the insurers are offering very narrow networks, often leaving out the best doctors and the best hospitals. In September, the Los Angeles Times reported that Blue Shield will have only about half the doctors in its exchange plan as it has in its traditional plan. One of the exchange plans in Colorado includes only a single Denver hospital, the one that usually treats Medicaid patients.

Narrow networks can be good or bad. Wal-Mart has selected a half-dozen centers of excellence around the country for its employees, places carefully chosen for their high quality and low costs. The exchange health plans, by contrast, appear to care only about cost. They are offering low fees -- sometimes even lower than the rock-bottom fees Medicaid pays health-care providers -- and accepting only those providers who will take them.

Under the Affordable Care Act, insurers are required to charge the same premium rate to anyone who wants to sign up, regardless of health status; and they are required to accept anyone who applies. This means that to make ends meet they must overcharge the healthy and undercharge the sick. It also means insurers have strong incentives to attract the healthy (on whom they make a profit) and avoid the sick (on whom they incur losses) by, in effect, making their plans less appealing to the sick.

Here's how they seem to be doing it: In structuring the plans they offer on the ObamaCare exchanges, the insurers apparently assumed that the healthy will choose the plan they buy based on its price, while ignoring other features of the plan. It makes sense: If I am healthy why wouldn't I shop for the lowest price? If I later

develop cancer, I can move to a plan that has the best cancer care. By law, these plans will be prohibited from charging me more than the premium paid by a healthy enrollee.

Insurers also assume that people who already are ill or otherwise expect to use a lot of health care pay much closer attention to the cost of deductibles and which doctors and hospitals are in the insurer's network. To have any hope of balancing their books, insurers must then attract the maximum number of customers who are likely to stay healthy and thus not use so much of the care they paid for, while unhealthy people in effect use more than they paid for. This is why most plans are apparently designed to attract people willing to overlook high deductibles and less access to health care in return for lower premiums.

Yet no matter how narrow the provider network, health plans are going to cost more if they enroll more people with above-average health-care costs. And that is what is about to happen.

For some years, the federal government and some states have operated and subsidized risk pools. These allowed the chronically ill and other high-cost people who were "uninsurable" to purchase insurance for the same premium healthy people pay. Under ObamaCare, however, the pools are due to shut down and send their enrollees to the exchanges, where the above-average cost of their care will be implicitly borne by higher premiums charged to everyone enrolled in the plans.

To make matters worse, cities and towns with unfunded health-care commitments are getting ready to dump their retirees on the state exchanges. Since retirees are above-average age, they have above-average expected costs. The city of Detroit, for example, is planning to dump the costs of about 10,000 retirees on the Michigan exchange.

Then there are the job-lock employees -- people who are working only to get health insurance because they are uninsurable in the individual market. Under ObamaCare, their incentive will be to quit their jobs and head to the exchanges.

In sum: A lot of high-cost patients are about to enroll through the exchanges. This will force up premiums further for all other buyers.

At some point, politicians of both parties will realize that we can do better than this. That will require a real market for health insurance with premiums that reflect real risks. There is a role for government in helping people with severe health problems. That is why risk pools exist. What we didn't need was to destroy the market for the many in order to give aid to the few.

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