The Obama Health Plan

By

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Senator Barack Obama has released only sketchy details about his plan for health reform. The Commonwealth Fund has produced a very detailed plan, however, and encourages its readers to view the two plans as very similar. For this reason, we assume the Commonwealth plan details apply where Obama has been unclear or unspecific.

Taxing Labor. The Obama plan would subject all employers to a "pay-or-play" mandate—imposing a tax on those who do not provide health insurance for their employees. Following Commonwealth, we assume this would be a payroll tax of 7% of earnings up to $1.25 per hour on employers who fail to pay at least 75% of the premium for a minimum package of benefits.

Were this provision enacted today, it would immediately affect the 40% of small employers who do not offer coverage, the 30 million people in families who have workforce participation, but no health insurance, and millions of Medicaid enrollees who have a workforce connection—to say nothing of all the employers who currently pay less than 75% and/or have plans that are insufficiently generous.

As the economics literature affirms, a payroll tax is almost completely born by workers themselves [link (abstract)]. During the Democratic party primary, Senator Obama criticized Senator Clinton's proposal to mandate coverage by asserting she would try to force people to

buy something they cannot afford and then tax them when they don't buy it—leaving them worse off than they were. Exactly the same criticism applies to Obama's pay-or-play mandate.

Destroying Jobs. As the economics literature has firmly established, a tax on labor (or mandated labor benefits) makes employment more expensive and encourages employers to hire fewer workers, adopt labor-saving technology, employ part-time workers, and outsource labor to independent contractors and other entities.

Encouraging Employers to Drop Health Insurance Coverage. Along with the pay-or-play mandate is an offer to the otherwise uninsured to buy insurance through a National Health Insurance Exchange with an income-related subsidy. Following Commonwealth, we assume that the premium would be limited to 5% of income for low-income families and 10% of income for everyone else. It will not take people long to discover that many (perhaps a majority) will be better off if their employers drop their current health plan, pay higher wages instead of premiums, pay Obama's pay-or-play tax along with income and payroll taxes, and let workers use their additional after-tax income to buy their own insurance in the Exchange.

Consider employees enrolled in an average family package costing, say, $12,000 (about the average for employer-based coverage), with the employer paying 75% of the premium and employees facing a 33% marginal tax rate. If employees can obtain a plan as generous from the Exchange, they are better off if they earn less than about $63,000. The incentives for employers to drop coverage are higher for lower-income employees and those with above-average health care costs.

Encouraging the Healthy to be Uninsured. Why pay expensive premiums for health insurance if you do not have any health problems? Under the Obama plan, there would be no reason to do so. Insurance sold in the Exchange would be guaranteed issue and community rated. This means people would be able to wait until after they get sick to insure and they would be able to do so without any financial penalty.

Encouraging Others to Overinsure. For those who do insure (especially those with health problems) and who reach the maximum premium limit, there is a different perverse incentive: They can buy more generous coverage at no personal expense. Although Obama would impose a minimum benefits package, there apparently would be no maximum. Theoretically, the sky would be the limit—with the marginal coverage all paid for by taxpayers.

Creating Perverse Incentives for Health Plans. In the Exchange, health plans would be free to set their own premiums, but they would be required to charge the same premium to all comers. This means the plans would make a profit on healthy enrollees and suffer a loss on less healthy enrollees. Consequently, the plans would have strong financial incentives to attract the healthy and avoid the sick. After enrollment, their incentives would be to over-provide to the healthy (to retain their membership and attract more of them) and under-provide to the sick (to discourage their continued membership and repel others just like them). (See my analysis of managed competition.) In the federal employee system, health plan advertisements during open enrollment period picture young, healthy families—never people with costly illnesses. And some plans are now discriminating against sicker enrollees to keep costs down for healthier ones. (See *The New York Times* article.)

Adverse Selection and Death Spirals. A number of voluntary heath insurance exchanges have been established in the past. Yet they invariably fail. The reason: healthier groups can usually find cheaper premiums outside the exchange. Yet when the healthier groups leave, the average cost for those who remain goes up—encouraging another round of departures. As the pool becomes sicker and costs rise, the arrangement collapses. Insurance exchanges only work where membership is compulsory (e.g. federal employees cannot take their employers contributions to outside plans). But Obama has specifically ruled out compulsory participation.

Encouraging Special Interests. Although there are very few mandated health insurance benefits at the federal level, state regulations require insurers to cover all manner of procedures, ranging from acupuncture to in vitro fertilization, and providers, ranging from natureopaths to marriage counselors. These mandates reflect the lobbying power of special interests, and the resulting higher price of insurance causes as many as one-in-every-four uninsured people to be priced out of the market. (See link.) By having the federal government impose a mandated benefit package, Obama would elevate this special interest feeding frenzy to the national level.

Substituting Government Insurance for Private Insurance. Obama would expand enrollment in Medicaid and S-Chip. (The Commonwealth Fund projects 12 million new enrollees.) Yet Obama's own health advisor (David Cutler) estimates that every extra $1 spent on Medicaid leads to a 50¢ to 75¢ reduction in private health insurance [link]. For S-Chip, the Congressional Budget Office projects a crowd-out rate of 25% to 50% [link (abstract)] and private estimates peg it at 60% [link]. In substituting public insurance for private insurance, the taxpayer burden increases substantially and health care doesn't get better in return. It gets worse.

An American Cancer Society study found that being in Medicaid is only slightly better than being uninsured as far as delays in diagnosis and treatment are concerned [link].

[Note: In the Commonwealth plan, Medicaid reimbursement rates would be increased to Medicare levels, but would still be below private plan fees.]

Encouraging a Two Tier Health System. Obama would allow people to join a public plan (presumably modeled after Medicare) as part of the Exchange. If it really looks like Medicare, it will not be very attractive. Most Medicare enrollees pay three premiums to three plans (basic Medicare, Medigap, and prescription drug insurance) and still have less coverage (e.g. the "donut hole") than the rest of the population typically has.

In the Commonwealth plan, Medicare for the young is reconfigured to look like normal insurance, but it will still pay Medicare rates. Many doctors today will not accept new Medicare patients and in some specialties Medicare patients face much longer waits for treatment than younger patients [link]. If a large number of people are added to plans that pay well below private fees, there will be inexorable pressure to respond to a two-tier payment system with two-tier quality of care.

Taxing Children. Although Obama would allow adults to remain uninsured, he proposes to force parents to insure their children—undoubtedly through a pay-or-play mandate. The problems here are: (1) mandates usually don't work if people have to pay any portion of the premium out of their own pockets, (2) the end result (health care for children) can usually be obtained less expensively through means other than mandated insurance, and (3) Obama's

criticism of Hillary applies here as well: He would try to force people to buy something they cannot afford, then tax them when they don't buy it—leaving them worse off than before.

Taxing Capital. Obama intends to pay for his plan by repealing the "Bush tax cuts for the rich." But there have been no tax cuts for the rich. [Link]. Lower *rates* on capital gains and dividends have induced wealthy investors to realize more income than ever—leading to record high tax revenues. Reversing these rate cuts is unlikely to produce any extra revenue. In the process, higher tax rates on capital will lead to a lower capital stock and a smaller national income in the future.

Note: It's always bad to tax capital to pay for current consumption. To tax capital to pay for wasteful health care spending that promises miniscule health benefits at the margin is especially bad.

Relying on Phantom Savings. Senator Obama plans to pay for the remaining costs by eliminating waste and inefficiency. His ideas include: electronic medical records systems, better disease management, pay-for-performance, and evidence-based medicine. Yet there is very little hard evidence that a demand-side approach to these reforms (with buyers of care essentially telling their doctors how to practice medicine) will save money.