National Healthcare Reform MAGAZINE

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Four Trojan Horses

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Of all the criticisms that have been leveled at "ObamaCare" over the past year, the four worst features of the legislation have been almost totally ignored — by Republicans in Congress, by the national news media and even by serious economists. So you're seeing it here first:

- People will be required to buy a product whose price will be rising at twice the rate of growth of their incomes and they will be barred from doing many of the things needed to control these costs.
- A bizarre system of subsidies will disrupt the entire labor market — causing massive layoffs and, ultimately, a complete restructuring of industrial organization.
- A health insurance exchange will give health plans perverse incentives to attract the healthy and avoid the sick; and after enrollment, to overprovide to the healthy and underprovide to the sick.
- A weakly enforced individual mandate will give people perverse incentives to game the system — remaining uninsured while healthy and obtaining insurance only after they get sick; choosing limited-benefit plans while healthy and scaling up to richer plans after they get sick.

The Ever-More-Costly Mandate. President Obama did not create the underlying problem. Health costs per capita have been rising at twice the rate of per capita income for the past 40 years. Nor is this a uniquely American problem. On the average, the same trend is in place for the entire developed world. But here is the bottom line: If you have to buy something whose cost is rising at twice the rate of growth of your income, that mandated purchase will consume more and more of your disposable income with each passing year.

To make matters worse, the normal consumer reactions to rising premiums are going to be disallowed. For example, most people would react by choosing a more limited package of benefits, or going to catastrophic coverage only or relying more on Health Savings Accounts. But these and other responses are limited or barred altogether under the new law.

The Bizarre Subsidies. Look at it from the employee's point of view. The new law says that an employee must have insurance costing, say, $15,000 for family coverage in 2016. Remembering that employee benefits are a dollar-for-dollar substitute for wages, that implies that a previously uninsured $30,000-a-year worker will get a 50% cut in pay. Further, the only help this worker will get from Uncle Sam will be the ability of the employer to pay the premiums with pretax dollars. That's worth about $2,000. On the other hand, if this worker can get the same insurance through the newly created health insurance exchange, the federal government will pay almost all the premium and reimburse most out-of-pocket expenses to boot. That's a total subsidy worth more than $19,000.

It follows that every worker in his right mind at this income level is going to want to work for a firm that does not offer health insurance and pays cash wages instead. Yes, this employer will have to pay a $2,000 fine. But the fine is well worth the opportunity to obtain a $19,000 benefit.

Now consider a $100,000-a-year worker. This employee will get no subsidy in the exchange. But insurance premiums paid by the employee will avoid a 15.3% payroll (FICA) tax, a 25% federal income tax and, say, a 5% state and local income tax. So at work, Uncle Sam is prepared to pay almost half the cost of this employee's health insurance. It follows that any worker in his right mind at this income level will want to work for a company that does offer health insurance.

In competition for labor, therefore, companies and entire industries will reorganize. Low-income workers will congregate in companies that do not provide insurance; high-income employees will work for firms that do provide it. Firms that ignore these worker preferences will not survive.

This implies two bad results: (1) much higher burdens for taxpayers as millions more take advantage of the subsidies than the Congressional Budget Office (CBO) has predicted and (2) an entire economy whose structure is based not on sound economics, but on gaming an irrational subsidy system.

Perverse Incentives for Health Plans. We have heard much from the White House and Congressional leaders about how insurance companies are abusing people. You haven't seen anything yet. Inside the health insurance exchange, no insurer will be able to charge a sick person more or a healthy person less. So insurers will try to attract the healthy and avoid the sick — even more than they do today!

Furthermore, after enrollment the perverse incentives will not end. Health plans will tend to overprovide to the healthy (to keep the ones they have and attract more) and underprovide to the sick (to discourage the arrival of new ones and the departure of the ones they already have). Of course, there are countervailing forces: professional ethics, malpractice law, regulatory agencies. But ask yourself this question: Would you want to eat at a restaurant that you know does not want your business? You should think the same way about health plans.

Perverse Incentives for Individuals and Families. A poorly reported development in Massachusetts is the growing number of people who are gaming the system. People remain uninsured while they are healthy and get insurance after they get sick. Then, after they receive care and their medical bills are paid, they drop their coverage again. This behavior is more likely, the lower the penalty for being uninsured and more weakly the individual mandate is enforced.

Under ObamaCare, the fines for being uninsured are low. When fully phased in, the fine is $695 for individuals who do not pay premiums of $5,800 and $2,085 for families who do not pay premiums of $15,200. Further, the IRS is indicating that it has no plans to enforce even these fines.

Individuals gaming the system could be the death knell for private insurance — leading to what many in Congress wanted all along; a single-payer private public plan.