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The Barack Obama Health Plan

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Sen. Barack Obama has released only sketchy details about his health reform plan. The Commonwealth Fund has produced a very detailed plan, however, which it encourages readers to view as very similar to Obama's. Thus, one can assume the Commonwealth plan details apply where Obama has been vague.

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Taxing Labor. The Obama plan would impose a "pay-or-play" mandate on all employers — taxing those who do not provide health insurance for their employees. Following Commonwealth, one can assume this would be an additional tax of 7 percent on payrolls — up to $1.25 per hour per employee — imposed on employers who fail to pay at least 75 percent of their employees' premiums for a minimum benefit package.

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

As the economics literature affirms, a payroll tax is almost completely borne by workers themselves. During the Democratic Party primary, Sen. Obama criticized Sen. 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.

A tax on labor (or mandated labor benefits) makes employment more expensive. It 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, the Obama plan makes an offer to the otherwise uninsured to buy insurance through a National Health Insurance Exchange with an income-related subsidy. Following Commonwealth, it is likely the premium would be limited to 5 percent of income for low-income families and 10 percent of income for everyone else. It will not take many people (perhaps a majority) long to discover that they 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 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 percent of the premium and employees facing a 33 percent 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.

In fact, 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 cost. 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 like them). Already, in the federal employee system, health plan advertisements during open enrollment period picture young, healthy families — never people with costly illnesses. And some plans discriminate against sicker enrollees to keep costs down for healthier ones.

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 to consumers. Most Medicare enrollees pay three premiums to three plans (basic Medicare, Medigap and prescription drug insurance) and still have less coverage (such as the drug-plan "doughnut hole") than those who are privately insured.

"Workers would bear the cost of a 'play or pay' health insurance mandate."

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. If a large number of people are added to plans that pay well below private fees, there will be inexorable pressure for providers to respond to a two-tier payment system with two-tiered quality of care.

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. 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.

It is always bad economic policy 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 practice.

Phantom Savings. Obama is now taking a page from the Clinton playbook, claiming savings from such measures as electronic medical records (EMRs), managed care, more efficient insurance and so forth. Savings will miraculously appear in every part of the system, according to his advisers. Obama claims there will be $200 billion in savings for ordinary people or $2,500 for "a typical family" every year.

However, the Congressional Budget Office estimates that EMRs will save very little money. The federal government found that its own experiment with managing the chronically ill saved not a dime. Other studies, including one by RAND researchers, predict that managed care or coordinated care or insurers-telling-doctors-how-to-practice-medicine-under-any-other-name may not save money, and in some cases actually increases spending.

Conclusion. It is hard to say under Obama's plan who will get what benefits, how they will get it or how much it will cost, but it is assuredly the case that the costs will be much higher than Sen. Obama's advisers predict, and it will be more difficult to achieve "universal coverage" than they assume.

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