IRET Congressional Advisory

June 21, 1994 No. 31

FREE MARKET IMPOSTORS IN THE HEALTH CARE POLICY FORUM

Many of the health care reform proposals floating around in the Congress are labeled "free market" by their sponsors. Even the Clintons characterize their proposal as providing a free-market health insurance system. Health care reformers obviously recognize that the public is leery about government's taking over the health care business and are playing to the legitimate popular desire for a government-free health care market.

If the buyer is required to buy or the seller is required to sell a specified product or service, the most essential attribute of a free market is absent.

Before signing on to a reform plan dubbed "free market" by its author, policy makers should apply a few simple tests to see if the label is warranted.

The essence of a free market is voluntary exchange between the buyer and seller of a product or service on terms that are freely negotiated between them. If the buyer is required to buy or the seller is required to sell a specified product or service, the most essential attribute of a free market is absent. If something other than the producer's perception of what best satisfies buyers' demands dictates the design or specification of the product or service, the market is not free. If the price of the product or service is determined in any way other than by unconstrained offers by buyers to purchase and by producers to sell, there is no free market for that product or service.

Applying these tests, the policy maker should ask whether a proposed health care reform plan *requires* people to have health insurance. President Clinton has made universal coverage the core objective of his reform proposal, and all but a few of the plans offered by Congressmen and Senators are promoted as doing the same. Most of these proposals, following the Clintons' lead, would make coverage mandatory. By its very nature, any such mandate, no matter how it is to be implemented, is at odds with the free-market requirement of a willing buyer engaging in a voluntary purchase.

Does the plan specify the benefits that the health insurance policy must cover? If it does, the insurer would not be free to design the policy to meet the perceived demands of different buyers. In view of the enormous variety of the relevant circumstances of the population to be insured, no single "one-size-fits-all" policy would satisfy everybody's preferences. If the plan is to merit the free market label, insurers must be free to tailor their policy offerings to the differing circumstances and demands of their diverse groups of customers, who must be free to purchase the kind of policy they — not the government — believe will best meet their needs. A plan that lays out the benefits that the insurance policy *must* provide is in the spirit of government command and control, not that of a free market.

Does the proposed plan specify the terms of the sale of the health insurance coverage? Would the insurer be free to charge differing premiums for any given coverage, based on actuarial assessments of the health risks of the differing groups of people to be insured? A health insurance plan that insists on

Institute for Research on the Economics of Taxation

IRET is a non-profit, tax exempt 501(c)(3) economic policy research and educational organization devoted to informing the public about policies that will promote economic growth and efficient operation of the free market economy.

1730 K Street, N.W., Suite 910, Washington, D.C. 20006
Voice 202-463-1400 • Fax 202-463-6199 • Internet www.iret.org

broadly-based community rating, hence only very limited premium differentials, would severely constrain insurers' freedom in marketing their policies.

Does the reform plan prohibit health insurers from denying coverage, for any significant period of time, to people with preexisting conditions or preclude the insurer's charging a higher premium for policies for such people? Excluding existing conditions as a factor in determining whether insurance is to be offered or at what premium is essential if everyone is to be covered, but it is most assuredly not consistent with the requirements for market freedom.

Does the reform proposal insist on policy renewal with no increase in premium, regardless of any change in the insured person's health? In effect, this is equivalent to requiring insurers to offer lifetime policies at fixed premiums that ignore the actuarial estimates of changes in one's health over one's life span. Imposing any such constraint on insurers violates their freedom to assess differences in cost conditions in designing and pricing their products.

Virtually all of the health care reform proposals under consideration in the Congress flunk these free market tests. The Clintons' plan would produce the antithesis of a free market. It would leave us only a small step shy of national health insurance, itself only a short hop away from nationalization of health care itself. Most of the other plans now under consideration suffer from one or more of the defects of the Clintons' plan and pose the same threat to the freedom of the health care market.

We are perched at the top of this slippery slope because policy makers across virtually the whole philosophical spectrum have agreed about the "need" for universal coverage. The basis for this presumption is that when people who are not insured require and receive medical care, those providing the care raise the prices they charge their paying customers. This results in higher insurance premiums for those who are insured. Eliminating this "cost shifting" by requiring universal insurance coverage, it is mistakenly believed, will reduce the cost of health care for everyone.

Eliminating this cost shifting, so it would seem, precludes allowing any significant number of people to be uninsured. Just as now, many of those who would forgo buying insurance would be poor, unable to afford even a minimal-coverage policy. Others would be individuals who would place higher priority on other uses of their incomes and employees who would prefer other forms of compensation to health insurance. Some of these uninsured people might incur health care costs that they could not themselves defray, resulting in the cost shifting that reformers deem to be anathema.

If one accepts the premise that universal coverage is an appropriate, indeed a key objective of reform, one is driven to accept mandated coverage. By the same token, however, one must not characterize one's plan as free market. Mandates are the antithesis of market freedom.

The same mind set that leads policy makers to believe that everyone *must* have health insurance also makes them insist on specifying the benefits the health insurance must pay for. Without this specification, some people would choose to purchase inexpensive, bare bones policies providing limited benefits, high deductibles, and high co-payments. Some of these people would, in all likelihood, incur medical expenses not covered by their policies and which they were unable themselves to pay for. The result would be the cost shifting that reformers seek to eliminate. Here, too, they are driven to accept specifications that are violently at odds with the requirements of a free market.

Similarly, virtually all of the plans call for community rating, permitting premium differentials only with respect to age, sex, and geography, at most. The objective sought by broadly-based community rating is to assure "affordability" of health insurance coverage. While such community rating entails much higher premiums for the young and healthy than would otherwise be called for, it also provides much lower premiums for people whose age, state of health, or other relevant attributes would call for substantially higher premiums. Community rating, too, shifts costs, but somehow its advocates believe *this cost shifting* is acceptable. In any event, community rating would deny insurers the right to adjust premiums to reflect objectively determined risk differentials. This not very subtle form of price control quite obviously violates the conditions of market freedom.

The universal coverage-affordability objectives also lead to prohibiting insurers from denying coverage or charging higher premiums to people with existing medical problems. Clearly, if universal coverage is to be achieved, no one could be denied insurance merely because the benefits that person is likely to claim are much greater, therefore call for much higher premiums, than the likely claims of people who are in good health. Most of the reform plans include such prohibitions, in themselves enough to belie the label of "free market."

Many of the plans would prohibit insurers from denying renewability or from charging higher premiums for renewing policies for people who have developed medical conditions that are likely to lead to above-average claims. These constraints are obviously required by the objectives of universal coverage and affordability. They are the capstone that would transform insurers into quasi-government agencies, guided by government dictates rather than by perceptions of how best to meet the demands of people seeking health insurance.

The erosion of market freedom that results from mandating universal coverage leads inexorably to further erosion of the freedom of participants in the health insurance market to engage in voluntary exchanges from which all benefit. Public policy makers would do well to reflect on where their initial steps toward imposing requirements, however modest they may appear to be, on health care market participants are almost certain to lead.

Norman B. Ture
President

Note: Nothing written here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before Congress.