

## The Economics of Obamacare

Guest: Robert P. Murphy

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**WOODS:** We have had request after request for somebody to walk us through the problems with Obamacare. This is a program we could have done a year ago, I suppose, and it's a topic that really is all over the news. It's all over the conservative, liberal, and libertarian websites. People want a basic overview. Just give us the quick 20- to 25-minute explanation of what the real problems with this thing are. I think people know about this problem or that problem, or the website doesn't work, or whatever, but we want to get into the fundamentals of why really will this thing not work. By "work," I mean satisfy the stated goals of its proponents.

It seems to me that if you're going to understand this you have to start talking about how Obamacare makes it difficult for an insurance company to manage risk. It's not that we're trying to make heroes out of the insurance companies, but insurance does perform a function, a service in a free economy. It seems there are major ways in which Obamacare impairs its ability to do this.

**MURPHY:** I think the main thing to realize is, first of all, that it makes it illegal for health insurance companies to turn somebody away. So an applicant comes up and has to be given a policy, but that's not enough. Everything about Obamacare really underscores Mises' point about how you can't have a limited intervention. That once you start changing what the market outcome would be, things just start unraveling. They've got to keep doing this, that and the other thing to fix all the unintended consequences. If they just said you've got to give a policy to everyone, they would say okay, sure. A guy with cancer comes up, and we'll charge him a \$1 million premium and give him \$1,000 worth of coverage. There you go. That clearly wouldn't satisfy what they wanted.

They also insist on minimum standards. So now all of the health insurance policies offered have to have certain levels of coverage. They have to be able to cover certain things. They can't just cover catastrophic accidents, things like that. So they had to insist on all the types of coverage in the policies. The most critical thing as far as why is this going to be devastating to the health insurance industry, or potentially so, is that they have to do what's called "community rating" for the premiums. That means it can adjust the premium only based on the geography and the age of the applicant. In particular, they can't charge men and women different premiums, etc. And what's really the kicker, of course, is they can't charge you a different premium based on a preexisting condition or your health history.

**WOODS:** Explain what the significance is of not being able to take preexisting conditions into account. This is, by the way, a part of Obamacare that even many Republicans—who say they want to get rid of it but add that they want to keep the good things, like the provision regarding preexisting conditions—support. But yet, what is the difference between saying that insurance has to cover preexisting conditions and saying you should be able to take out homeowners' insurance on a house that's on fire? A lot of people say that and they get criticized for saying that. You're just being facetious, critics say. You're not taking this seriously. But what is the difference?

**MURPHY:** There is no difference. You're right that if somebody comes up who the insurance company knows is going to be costing them thousands of dollars' worth of medical expenses over the next few years, they can't adjust for that when they're setting the premium. They have to charge that person the same as if a person of the same age and the same geographical region applied.

There is a little bit of a tweak, though, and that's where your listeners may know there are these things, these open enrollment periods. So you can only sign up for Obamacare during certain periods of time, and then you'll lose the ability to do that for that calendar year. The sensible function of that I believe is to try to avoid people gaming the system and waiting until they get sick and then signing up. But you're right. As far as the principle of the actuarial concept behind it, it's as if somebody who gets into accidents all the time and somebody who has a perfect driving record apply and the car insurance company has to give them the same price.

**WOODS:** Bob, how would you answer this kind of argument: you libertarians have a lot of criticisms, but the fact is there are a lot of people who have preexisting conditions who are in really impossible situations health-wise and financially. And no, this is not a perfect solution, but in the previous system, before we had Obamacare, everybody knows prices were completely out of whack. People could get absolutely wiped out financially by just one really severe health problem. And yeah, you can criticize Obama all day long, but at least these people will be able to get some coverage. Whereas in your libertarian utopia, they would just be left out to pasture. They'd be left out to die. What do you say to that?

**MURPHY:** Well you know, actually I do regret that we're having to call it Obamacare, because that makes it look like this is something about that particular guy, or it's the Democratic Party. You and your listeners of course know that's silly. This is the same sort of thing Republicans would do, in fact. Mitt Romney himself is no opponent of government getting involved with health insurance. But I think here, as with just about anything else when these issues come up, yeah, there's something wrong with the world. It would be better if nobody ever got sick and given that people are sick, some people have more money than others. And it makes us feel bad, and we want to do something about it.

The question is what's the appropriate way to try to help people who are less fortunate or find themselves in these awful circumstances, and we can show scientifically using economics that what they're doing is going to exacerbate the problem. That having the government get more involved in health insurance is not going to make it cheaper for people. It's not going to reduce the cost of medical care unless it does that by rationing. So in terms of a better system and what would happen? There would be philanthropic organizations. It would be a lot cheaper to get medical service. The AMA, the American Medical Association, I think has a huge role to play in driving up the cost of medical care, where only licensed people can be doctors and so forth. If you want to take a broader look and explain why is it that the delivery of medical care has such problems, to me the answer is clearly not because there's not enough government involved.

**WOODS:** It's definitely true that there's a supply issue, and that's exacerbated by Obamacare, because fewer people are going to want to be doctors when they have even more and more layers of government hoops and bureaucracy to jump through. The AMA of course also is supposed to be accrediting the medical schools, and there are some states that have only one medical school in the whole state. You could say that's because they want to maintain the highest standards, but you'd have to be a naïve idiot to think that's entirely what's going on. So there's certainly some supply aspects, and of course restrictions on what non-MD figures in the healthcare industry are allowed to do, even when they're simple things that basically almost anybody could do.

There's a demand issue as well that is encouraged by the growth of the third-party payer, where nobody feels like he feels the real cost of care, so demand gets driven up. Everybody thinks, well, sure, I'll go down to the doctor because I feel tired. Well, you're 78. No wonder you feel tired. So when you look at all this, and you try to say to people there may be an alternative to Obamacare. And they say the alternative is what we had before, your beloved free-market system. Is that a free-market system? How do you answer that?

**MURPHY:** It's clearly not. Their last point is worth elaborating on, which everyone knows from experience, especially if you have kids: you go to the doctor, and they tell you, oh yeah, you've got to go see this specialist for this, this, and this. It's not like you're going to go buy a new computer and you're going to do

some research and ask your friends and go read. Or you buy a new car: you want to see the different models and the prices. In medical care, you just take that as gospel. Oh, okay, I've got to go to this specialist. You don't even find out until afterward how much the thing is going to cost. I even tried to brace myself when going in for something like that to know how much is this going to cost me, and they'll tell you. And then you'll get bills from other people down the road—well, that was just from the doctor's services; this is from the anesthesia, etc. As if they thought when you called up and wanted to get a ballpark figure that you didn't want anesthesia to go along with the package.

The main reason for that particular phenomenon is that people are not directly paying out of pocket. That there are third parties in between, whether it's the insurance company or whether it's Medicare. A large reason for why people's insurance is provided by their employer. Think about it. That's kind of weird. Why is it that the people typically get their health insurance from their employer, whereas they don't get their car insurance from their job? A big part of that is because of the tax code. The way those benefits are treated. It's a taxable deduction from the employer's point of view. They're paying wages, but it's not taxed on the employee side. Whereas if they just gave you the money and you bought the health insurance yourself, those would be after-tax dollars. So there are lots of things that prop up this current system and that give us these screwy outcomes. Again, looking at other areas too I can't think of an area where something wasn't working satisfactorily, and we brought in a federal agency, and that made it run more efficiently and save money. That's just crazy.

**WOODS:** What do you think is going to be the result in terms of the average person and what he will wind up paying? Obviously some people are going to be subsidized. There'd be no point of the thing if there were absolutely zero beneficiaries. There'll be some beneficiaries. But the typical working stiff—what's he going to wind up paying? We're reading a lot of horror stories of people's premiums going through the roof, but then you have people on the Left who say that's exaggerated. That's only a few cases. What do you think is going to be the overall effect for the average person?

**MURPHY:** There are a few things you have packed into there. First, I just want to be clear: even the defenders of the system, when they try to explain how great it's going to be, they always are explaining after all the subsidies and so on. The way the government's going to come and help you pay for it. So nobody is denying that the actual price of health insurance is going to go up if you're putting more people into the pool who previously weren't covered, because they had preexisting conditions. That's got to happen. The other thing, too, that I don't think we should forget is there were going to be lots of people who are now forced to get health insurance who before were paying zero, so they're going to see an infinite percentage increase. It's because some of the people who weren't getting it weren't in that position because they had cancer and nobody would give them a policy. It was because they were young and healthy and just thought, this is too expensive for me. I'm just going to hope I don't get sick, or I'm going to go to my parents if I get sick or whatever. Clearly, no one typically factors that in when people are discussing what's going to happen to the average person under this.

I've seen all kinds of different studies with these things. To be honest, as an economist, I can give you any answer you want. When you run these things, it's just depending on which factors you put into it. So the Heritage Foundation, for example, has used a model, and they have it in various states more than doubling premiums. I find that plausible, but other studies, where the people like Obamacare, are going to find oh no, it's very modest increases. One thing that should be a warning flag to the people is when the federal government itself, I think back in September, put out a study trying to show people how affordable this was going to be. They were comparing the actual premiums that were occurring on [www.healthcare.gov](http://www.healthcare.gov) to what the previous estimates were going to be. They weren't comparing it to what people were actually paying before which would be the national baseline. You see what I'm saying? They were just saying, oh, this is coming out much cheaper than anyone thought it would be. Those were like the headline figures they were trumpeting. Not this is going to reduce prices for the average person.

So it would be silly for me to throw out a number, just because there are so many moving parts in something like this. Also, it depends on how many people enroll. The number of healthy people, if they just shoot to pay the fines, then the insurance company is going to have to adjust their premiums accordingly. There are various things that you just can't know until you see what ends up happening. I think clearly you're going to see massive premium increases in several states.

One last thing, the reason it differs from state to state is that it depends on what the regulatory environment was in that state beforehand. Like for New York, for example, I think they had pretty high standards about what kind of policy the health insurance companies could offer, so Obamacare's main effect on people in New York is that it's just going to force everyone to get insurance and not actually make the insurance companies ramp up their plans too much. Whereas in other states it was more liberally regulated, they're the ones really getting hit. And that's where you're seeing these projections of premium increases of over 100 percent.

**WOODS:** If Obamacare is placing restrictions on the freedom of action of insurance companies to make decisions of coverage and premium terms and amounts and all that, and they can't take certain factors into account—or they can, but not to the extent that they might otherwise—then the question of course becomes: why did the insurance companies all favor this? The only two explanations I can come up with are, first, they thought that the individual mandate, which would require everybody in the country to purchase their services, would more than compensate them for the negative aspects of Obamacare. Maybe they thought the one outweighed the other. Or secondly, when the federal government wants to take over a huge chunk of the U.S. economy, and they are determined to do it, you don't want to be perceived as being an obstacle to that. You don't want to be on the government's bad side. So of course you're going to toot the horn of the policy and be thrilled with it on paper and in public. Do you think either of these is on the money or is it both? Is there a third option I've overlooked?

**MURPHY:** I think those are both correct. Just to elaborate a little bit on them, and no, I'm not on the inside of the heads of the various people running these companies. Just with my consulting work in general, especially on energy issues, where I've seen firms that would get hurt by a carbon tax and yet they're spending money publicly promoting it, talking about how they're a green company. *Prima facie* that looks odd, but it has to do with the sorts of reasons you're talking about. A lot of times they'll use phrases like oh, that train's already left the station—meaning, we can't stop this thing. We might as well just do what we can, so the particular details of the legislation are to our advantage and hurt our competitors, or if you're a bigger company that it'll make it harder for the little guy to compete with you. Whereas the bigger companies can more easily comply with that stuff. So I think it's a lot of things like that. And yes, your other point was also correct that given that it's going to happen, and they think we're not going to be able to stop this, when the dust settles they don't want to be remembered as having actively opposed it. The government is an incredible power over them and could destroy their business if they want to. You don't want to be in that position, so I think that's part of it too.

**WOODS:** Bob, I realize this is sort of a personal question, but I wonder if you'd feel comfortable sharing with the listeners your own personal experience under Obamacare and the Orwellian letter that you received from your health insurance provider.

**MURPHY:** Right, yeah. Because I'm a consultant and self-employed, I was buying my own health insurance, and I'm one of the millions of people who are getting these letters telling people that because of the Affordable Care Act, your policy does not meet the minimum standards. So in particular, what that meant was I had what we would colloquially call a catastrophic policy. I don't get sick very often, so I was to keep a lower premium. I had a really high deductible. So I was paying out of pocket up until some big number, at which point the insurance would take over. That was deemed inadequate policy according to the Affordable Care Act. So my insurance company sent me a letter saying I wouldn't be able to do this anymore. I don't have it in front of me, of course, but you're right: it was some sort of Orwellian language about, "But look

forward to this, because the new policy you're going to get is going to be even better. And it's possible that there will even be a lower price." They didn't promise me it was going to be a lower price, because clearly it's not going to be. They're giving me what's in their perspective a more generous policy. They're going to charge me more for it.

**WOODS:** Of course, by implication they're making themselves look pretty stingy and stupid and thoughtless, saying to you, in effect, well, all along we've had a policy with much better features and a lower price that we haven't bothered to tell you about until now.

**MURPHY:** The other thing, too, it's not just with respect to me, but of course now they have to cover more people in my age who previously would have been turned away because of preexisting conditions. The whole thing about "if you like your plan you can keep it." Again, same thing with [www.healthcare.gov](http://www.healthcare.gov) not working. These are actually just minor issues compared to the concept. It just epitomizes him getting up there lying to people, when his own advisors clearly knew that this wasn't going to happen. They have memos going back years talking about how many people in the individual coverage market—the people who are buying it off the shelf and not getting it from their employer—about what large percentages of those policies were not going to be deemed adequate. There were going to be millions of people getting cancellations, but they just decided politically, no, we don't want to give the Republicans a gift. They'll hammer us for it. Let's just keep talking about this.

**WOODS:** Bob, you've been teaching a course on the economics of Obamacare over at the Mises Academy, so you seem like the perfect person to take this on. Suppose you were standing in front of an audience that really has no strong opinion one way or the other, and you've got maybe three minutes to make them concerned about this, to point out in bullet-point fashion without much elaboration, here are the things to be concerned about, about the Affordable Care Act. How would you handle that assignment?

**MURPHY:** First of all, I would focus on the individual mandate and just say that this is astounding that the federal government is forcing people to buy a product. That's really sort of unheard of, and that the way they're doing it is by giving these fees. They're called the "individual shared responsibility fee," but of course it's a tax. The way they're roping people into it, in 2014, they taxed us \$95 per person per year. So if you choose not to get health insurance, they don't throw you in jail. They just tax you extra when you file your taxes the next year, or it's one percent of your income, whichever is greater. So even that right there is pretty misleading, because the \$95 doesn't seem like a big number, or it's one percent of your income—which, depending on how much you make, could be a bunch.

By 2016 it goes up to \$695 a person. That right there should tell you how much they think premiums are going to skyrocket, if they're thinking there might be people out there who need to be threatened with basically a \$700 fine for not buying health insurance. If that's the side of the stick they need to have there.

Then another thing that just really jumped out at me involves these Cadillac plans. These are plans where the employer gives it to the employee and it's too generous of a policy as far as the government is concerned, where there's either a very low deductible or there's no deductible. They're saying these Cadillac plans are driving up the cost of health care, because now you've got all these employees going around getting care who aren't watching the cost. So the solution to that is, starting in 2018, they're going to impose a 40 percent excise tax on the cost of those plans in excess of like \$10,200. If the employer is having a plan for his employees and they cost the employer more than basically \$10,000, he's going to get slapped with a 40% excise tax on that. Obamacare's really hitting you from both sides. On the one hand, if you don't want to have insurance, or you wanted a really catastrophic plan to keep your premiums down, it's now illegal for that to happen. On the other hand, if your employer gave you a really generous policy, that now is going to get hit with a huge tax. So they're funneling everybody into a one-size-fits-all thing.

I think the last thing in terms of trying to get the average person to understand why this is scary is that a lot

of the projected savings in terms of how is this going to reduce medical expenses is coming because the government is going to now more aggressively bargain with health-care providers in terms of well no, we're not paying this, we're not paying for that. The more people become dependent on having their health care paid for by the government either directly or indirectly, this is what people are talking about with that phrase "death panels." You can say that's a silly term. Okay, but the point is now the government has to. This isn't something that's some scary thing that may come to be. No, it has to be. Their own projections are showing that they're going to save money for the taxpayer by bargaining aggressively and not paying for certain kinds of treatment. So do you want the government to be in charge of what things are covered in your health insurance and what they're going to pay for or not? I think most people would recognize that that's pretty scary.

**WOODS:** If you had now just a couple of minutes to give an overview of what should have been done. It's not enough to say they shouldn't have passed Obamacare. We know that, but everybody knows there's something screwy about the health-care market and how the prices are all crazy, and they don't correspond to anything real. So what should have been done instead?

**MURPHY:** One obvious thing would be to ideally abolish the license thing, medical practitioners, so anybody that wants to be a doctor can do that. You don't need a special permission from the government. I know that sounds crazy to people. So I suppose if you wanted to be wimpy about it you could do intermediate things and say the government could still issue all of those things, but they're voluntary. In other words, they will still say, "These are the people that we the government say are good doctors, but you're allowed to go to somebody else if you want to." That, I think, would open up a huge amount of competition and drastically slash prices right there. Beyond that there's various things in terms of intellectual property and copyright in terms of pharmaceuticals that the cost of certain drugs would be a lot lower if you didn't have that stuff being enforced by the government, so that's another obvious remedy. As you know, there's a whole branch of medicine that people dismiss as being quacks or whatever, but there's a lot of stuff that it's easier, it's more effective to get treatments that are not part of the establishment-approved techniques. I just think opening that up really is the ultimate solution to this rather than tinkering with the health insurance market per se. I think opening all of that up. There are things too about being able to compete in various states. There are regulations right now limiting health insurance companies' ability to do that, so there are all sorts of impediments to the normal competitive market process.

And you wouldn't see crazy things like hospitals being able to charge someone \$60 a stitch, or whatever that figure was. That would not survive if there were a place down in the strip mall that did the same sort of procedure just on an outpatient basis. You don't need that much training to know how to give somebody stitches and not give them an infection. The market reputation for that—if you were giving people infections, your place would go out of business. This idea that medical care is some special thing that really needs the oversight of the government is laughable. Even if it were somehow unique, then the government is the last agency in the world you want to have responsible for oversight in such an agency. I think that all these things just again show that the market is the way to go, and that government intervention just makes it worse.

**WOODS:** Bob, I've got somewhere one of my resource pages on my site is on healthcare and free market healthcare and what it would look like and some proposed changes. As soon as I can fish around to find it, at the end of this program I'll link people to that and then of course, encourage people to follow you at [www.consultingbyrpm.com](http://www.consultingbyrpm.com) and click on your blog and put it in their RSS feed, so they can always get what you're working on and writing about.