

The Affordable Mortgage Depression

Government policies were designed to increase homeownership. Affordable Mortgages, created to realize this goal, were responsible for the Housing Bubble and distorted the economy. The unwinding of these distortions will result in a Global Depression.

Common Sense Solutions to the U.S. Healthcare Problem: Part I "A Tragic Mistake of History"

The present healthcare debate is a political exercise. The crisis of rising expenses has been expediently framed as a choice between national bankruptcy and a Government program which is purported to restrain future healthcare costs.

Prior to proposing or adopting a solution to the stated problem, it is a reasonable exercise to identify the actual cause of unsustainably rising expenses. The source of the increase is obviously specific to healthcare, as the cost of other goods and services in society has not risen consistently at a rate in excess of inflation.

Prior to 2006, housing prices might have been included in this same category. It is fascinating that the unsustainable rising cost of homeownership was largely celebrated, but growing healthcare expenses are reviled. The obvious difference being that housing is an asset and healthcare a consumed service, but these price distortions are closely correlated.

TheAMD.com has demonstrated that housing prices were largely inflated by Government interference in the mortgage and housing markets. This perspective is increasingly accepted. Yet as many decry the perpetual rising costs of healthcare, few blame distortive Government interference as the source.

The following analysis attempts to answer two fundamental questions:

- Why are expenses rising so rapidly?
- What could reasonably be done to correct the problem given an understanding of the cause?

The observations made are not derived from political theology. They are based on economic and historical reality.

A Tragic Mistake of History Born from Price Fixing

During World War II Congress fixed wages in an attempt to control prices within an economy focused on waging a global conflict. Price fixing does not work and companies adapted nimbly to the artificial constraints. Employers began offering healthcare benefits as a means by which to enhance compensation and attract employees.

Congress decided that this accidental relationship was attractive and extended a tax deduction on employee benefits to companies that provided health insurance. Strangely, the Government did not extend the same tax deduction to individuals. In doing so, Congress institutionalized the provision of health insurance through employers.

To reiterate, no one in Congress dreamed up this dynamic. It wasn't proposed as a good or efficient idea. The tax deductibility of employee benefits is simply an institutionalized mistake of history born out of price fixing.

The dynamic is objectively unattractive. It is easy to see one of the system's flaws in an environment characterized by massive job losses. By correlating individual health insurance to employment, Congress unnecessarily created a relationship which magnifies the impact of economic downturns.

Most Americans do not question why it is that we receive our health insurance through employers. There are no inherent advantages to a company providing its employees with any consumer good or service, including insurance products, but there are plenty of distortive disadvantages. Were this not the case companies could and would provide employees with a range of consumer products including auto, life, flood and hurricane insurance policies.

The argument is boldly and consistently asserted that companies are able to provide health insurance to employees more cheaply than they could acquire it individually. This assertion is flawed.

1. If it were true, then why have healthcare costs been rising unsustainably for decades?
2. Aggregating the purchase of any uniform item can produce cost savings, especially when purchasing commodities. If a company provided its employees with avocados, wheat or flat-screen TVs, it could certainly do so more cheaply than an individual could acquire them.

But insurance is not a commodity. Nor does the employer-provider dynamic actually work when applied to commodities. Each employee would optimally choose to consume a different quantity of avocados, wheat and flat-screen TVs than the uniform amount doled-out by the company. The same reality applies to healthcare insurance.

3. The argument for capturing cost savings through the aggregation of purchases could be applied unconvincingly to almost any good or service.

Imagine a company with 10,000 employees. Today those 10,000 people (assuming each has a car) would likely individually possess 10,000 different auto insurance policies given the large number of car insurance providers and the flexibility with which one can establish deductibles for collision, personal liability, property damage, bodily injury and property damage claims. Each employee may customize his or her policy based on their own specific circumstances, economic situations and preferences. This is how free markets produce efficient outcomes.

If the same company were to provide car insurance to its employees all 10,000 would have the same policy. This arrangement is extraordinarily inefficient even though some theoretical cost savings were captured by the bulk purchase. Some employees would be stuck with higher deductibles than ideal, others lower. When personal choice is eliminated from consumption decisions, the cost regulating and efficiency capturing influence of the free market is eliminated and costly distortions result.

If the auto insurance example is unconvincing or you presently believe that what is important is that the employees are insured, try substituting dinner (or anything else) for insurance.

Certainly a company could provide its employees with dinner more cheaply than each could individually. Instead of 10,000 people choosing to cook, grill-out, go to a restaurant, eat ice cream or lose weight by skipping a meal, all 10,000 would be fed the same thing. Dieters, Vegetarians, Diabetics, those with hypertension, spinach-haters and Atkins devotees would all be provided the same food. Certainly each employee would be fed cheaply and no one would go hungry, but this would be a terribly inefficient model producing net benefits (and utility) far beneath those resulting from individual choice and preference. It does not matter that some employees would pay more to feed themselves dinner, the outcome of 10,000 individual but efficient decisions is far preferable to 1 cheap, company-provided option.

4. When an employee is provided with health insurance the costs and incentives associated with consumption are dramatically distorted. The marginal cost of healthcare in this situation is low (or free) depending on the deductible, and is certainly much lower than it would cost to pay for healthcare directly. As such, an excessive amount of the service is consumed because cost of consumption is disconnected from price.

This dynamic, which encourages consumption, would be corrected if individuals had the opportunity to buy their own customized health insurance policies. The opportunity costs of paying for a policy of one's choosing would re-incentivize individuals to make efficient decisions about how much insurance they purchase, healthcare they consume and where they establish deductibles. A preference for, or expectation of, higher consumption would translate into the choice to pay more for a policy which included lower deductibles.

In every instance other than healthcare, we individually pay for what we consume leading to efficient outcomes. If the cost of eating dinner at Outback Steakhouse was a \$10 co-pay, far more steaks would be consumed. The only way a person consumes the correct amount of health insurance or steaks is if they actually pay for the items themselves.

The reality is that the provision of health insurance by employers is a market distorting failure born from price fixing and perpetuated by Congressional ineptitude.

A Common Sense Solution

If Congress would simply:

- Provide the same tax deduction for the purchase of health insurance to individuals as that which it extends to employers and,
- Allow employees the opportunity to receive in cash the amount of money which would have been spent by the employer on their health insurance benefits,

...then free market forces would be restored and the consumption distortion problem would be eliminated.

Individuals, employed or otherwise, could afford dynamic insurance policies and would have access to a diverse, market-provided opportunity-set.

If you give employees their own money (contingent upon them buying insurance coverage), and allow them to keep what they don't spend, they will make the efficient consumption decisions for their unique situations and preferences.

An Observation and Opinion: The Functional Effect of Institutionalized Employer Provided Health Insurance has been to Eliminate the Beneficial Influence of Democracy

If individuals paid for health insurance like they do everything else they consume, then voters would be directly sensitive to price. Do you recall the recent angst over \$4 a gallon gasoline?

The current failed dynamic, perpetuated by politicians, functionally acts as a circuit-breaker between voters and health care costs (which are largely influenced by Government policies). It is companies that bear the direct costs of health insurance. Employees pay only indirectly by receiving less compensation, smaller raises or losing their jobs. But employees do not know the direct cost of their insurance nor do they see its price rise annually. Do you know precisely what your company pays to provide you with health insurance? Do you know by how much this amount increased over last year?

If individuals purchased their own health insurance they would be sensitive to increasing prices, respond dynamically to such changes, and to the extent that rising costs were the direct result of intrusive public policy or bad Government, voters would hold politicians responsible for these abuses.

It is my opinion that politicians perpetuate the current dynamic because it affords them the latitude to endure, or directly cause, rising health care costs without being held responsible by voters.


Other Solutions To Follow Include: "Common Sense Dictates the Need for Tort Reform", "The Influence of Government Health Insurance Mandates" and "The Inability of Government to Contain Healthcare Expenses or the Cost of Unfunded Pension Liabilities".

 my.delicious.us

 My Stumbles

 Technorati This!

 Digg This

Posted by Whitney Ross at [7/28/2009 10:54 AM](#) 

Categories: [Dismal Reality](#), [Policy Suggestions](#), [Lessons From History](#)