BOOK REVIEWS

The Healthcare Fix: Universal Insurance for All Americans

Laurence J. Kotlikoff
Cambridge: The MIT Press, 2007, 96 pp.

This book is about how and why a severe economic and financial crisis may well unfold in the United States within the next few years. The main reason: politicians have been increasingly profligate with the public purse—expanding government entitlement and nonentitlement spending, seemingly without regard for future economic consequences.

The main focus of the book is on the runaway costs in the health care sector—the main threat to future fiscal solvency and economic security. The book draws a clear contrast between the conventional view that higher health care spending properly reflects our collective preference to allocate more of our money to health care for retirees—versus the alternative—according to which today's decisions to increase pay-as-you-go retiree health expenditures expropriates resources from future generations.

The author has convincingly argued, here and elsewhere, that the intergenerational redistributive effects of current fiscal decisions—which may well bankrupt the nation—are underemphasized in public policy debates and ignored by lawmakers motivated more by their desires for reelection than by their duty as stewards of the nation's economic future.

The Healthcare Fix identifies three problems plaguing the U.S. medical care system: Many millions of uninsured people, escalating federal and state health care entitlement costs for Medicare and Medicaid, and increasing costs of employer-provided and privately

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purchased health insurance. The book's goal is to show how scrapping the current system and adopting a new Medical Security System (MSS)—could resolve all three problems—without raising taxes, to boot.

The main problem concerns accommodating the projected rapid growth in the health care sector's output share at a time when GDP growth is projected to slow because of slower labor force growth from baby-boomers retirements. The book describes its proposal as "radical but simple." It is, indeed, radical because it eliminates major government health care subsidies: Medicare, Medicaid, and employer tax deductions for health insurance expenses. But it is by no means simple because it envisions an even larger government role in determining the allocation of public health care dollars by adopting a universal health insurance system.

A significant expansion of government intervention is justified by claiming that paternalisms runs deep in American society—even among those that overtly profess to be anti-government. That justifies government determination of minimum provision of basic goods such as food, shelter, children's education, health care, and so on. In regard to health care, Kotlikoff claims that market failure from adverse selection in health insurance is so severe that adopting a universal health care insurance system is the only solution.

In theory, adverse selection arises because those in good health and with low risk of health problems choose not to purchase health insurance because premiums based on average health risks do not adequately reflect their relatively better health. The resulting higher insurance premiums may induce low-income individuals to also drop out of the health insurance market.

In the United States, only about one-half of the 47 million non-insured individuals are low income or jobless persons, whose health tends to be worse than average. Moreover, several millions are illegal immigrants, so underinsurance among legal residents is smaller still. Even among children, the data suggest alternative federal and state sources of insurance for partial years, which imply a lesser degree of non-insurance compared to official estimates based on the absence of insurance during the full calendar year. Many who are counted as uninsured are eligible for Medicaid but are not enrolled in the program. And a large segment of the uninsured comprises healthy individuals who may voluntarily choose to forego health insurance at existing premiums as predicted by adverse selection

theory. Thus, the widely cited 47 million estimate of the number of uninsured is considerably overblown, as is the book's case for universal health insurance based on it. Although future budget expenditures and health insurance costs are projected to increase too rapidly for comfort, those factors alone do not support the case for universal health insurance.

Health care reform proposals are a dime-a-dozen today. The book provides a "paternalist's" critique of three major ones: President George W. Bush's proposal to exempt from income taxes up to $15,000 in health care expenses for everyone—even those not covered under employer plans—lacks compulsion, doesn't help low-income groups, does not address problems of adverse selection, and is too generous toward high-income groups. "Hillary-care"—the plan developed under President Bill Clinton's Administration in 1992—is too complicated and would require a huge bureaucracy to operate; and more recent proposals in California and Massachusetts for mandating health insurance purchases with subsidies for low-income individuals would expand Medicaid enrollments and worsen government budgets. None of these plans adhere to the author's paternalist vision of universal health care "without subsidies."

Kotlikoff claims that his 10-point Medical Security System would be superior. MSS makes participation mandatory and awards vouchers to all for purchasing health insurance. Voucher awards based on individual experience ratings would provide more resources to high health risk individuals for purchasing broader health insurance coverage. It would also reduce insurers' incentives to deny coverage to those with high health risks. Growth in total voucher value would be limited to GDP growth. Insurers would compete to provide health plans in conformity with basic coverage as defined by the government.

A problem could arise, however, if there were insufficient data for constructing experience ratings. The government currently has considerable data on the health risks facing the elderly, but similar data may not be available for younger age groups of all types. Second, experience ratings for different groups are usually based on the assumptions of independence and homogeneity (across both risk types and over time), but both assumptions may be violated in practice. For example, it remains unclear to what extent the government

would be "on the hook" under a contagious disease outbreak such as the much-feared avian flu.

Kotlikoff proposes to limit voucher growth to growth in aggregate GDP. But vouchers by themselves will not solve the Samaritan's dilemma, which lies at the core of the current system's problems. Lawmakers can refuse neither to spend more on newer and more costly procedures under Medicare and Medicaid nor to recognize and cover additional health conditions and "diseases." A voucher system also will not eliminate deadweight costs of intense lobbying by the patient and provider groups—coalesced around specific diseases and specialties—for obtaining additional vouchers and being included under the government's "basic insurance coverage" category.

Further, future GDP growth will likely become increasingly divorced from growth in health care needs due to population aging. Absent government intervention, market supply and demand would probably cause the health care spending to increase as a share of GDP: A larger share of relatively wealthy retirees would spend more because of age-related needs. Even successive generations of young individuals would spend more as their incomes increase because, as the book explains, health care is a superior good. Thus, if government spending were held constant as a share of GDP, private spending would increase faster as would the scope for adverse-selection to play out vis-à-vis out-of-pocket purchases of health insurance. Even in the short term, tying voucher awards to GDP growth would cause them to shrink during recessions—precisely when the need for heath care peaks from groups vulnerable to job losses and negative income shocks. Fundamentally, a rationale for why aggregate voucher awards should be pegged to GDP growth—or, indeed, be maintained at any particular (slower or faster) rate of growth compared to GDP growth—is never presented.

Another shortcoming in the book's approach is its exclusive focus on the demand side of the health care sector (via health insurance reform) to the complete disregard of its supply side. This is an elementary economics issue: If the relative price of a good or service increases consistently, it is because demand continues to outstrip supply. Reform proposals should focus on expanding supply in addition to slowing demand growth, and not just on the latter.

Indeed, imposing tight expenditure constraints could adversely impact the long-term supply of health care services. Even today,

many hospitals and doctors—especially the more qualified and highly reputed practitioners—reject Medicare and Medicaid patients on account of strict price controls exercised by the government. Introducing more draconian non-market controls (those not driven by citizens' preferences) may exacerbate the relative unavailability of coverages and health services to low-income groups unable to supplement government vouchers out of their own funds. If the rationing and price controls that the book advocates affect health care supply adversely, the relative price differential between health care and other consumption may become larger rather than smaller.

Finally, the proposal envisions government control over all types of health care services, the amount of coverages allowed and disallowed, the rate of growth of vouchers, who receives rebates and who doesn't, what type of behaviors earn rebates, what types do not. This is tantamount to introducing non-market rationing with a large scope for errors. It is instructive to note that market failure in a sector doesn't necessarily justify massive government intervention—or, in this case, a replacement of one type of intervention with another—because government failure under the new system could turn out to be even more serious.

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