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The rate-shock danger

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WILL Obamacare increase or decrease the average cost of an insurance policy on the individual market? There seems to be some controversy over the question, though no one seems to disagree about the pertinent underlying facts.

Last month, California's new health-care exchange, Covered California,happily announced, "The rates submitted to Covered California for the 2014 individual market ranged from two percent above to 29 percent below the 2013 average premium for small employer plans in California's most populous regions." Okay. But why compare rates on the individual market to premiums of small employer plans?

Health-care wonks sceptical of claims about the economies of Obamacare immediately called shenanigans. Michael Cannon of the Cato Institute (a colleague of mine when I worked there) persuasively accuses Covered California of premeditated dissimulation. AvikRoy of the Manhattan Institute compared the rates in Covered California with current online quotes from insurers and found that "Obamacare, in fact, will increase individual-market premiums in California by as much as 146 percent". This did not go down easy with the knights of Obamacare. Ezra Klein accused Mr Roy of confusing the issue by failing to note that the individual market is quite small, and that the lowest rates quoted by insurers are not available to those with pre-existing conditions.

Paul Krugman, ever the gentleman scholar,accuses Mr Roy of knowingly "making an essentially fraudulent argument". Mr Klein's follow-up and Mr Roy's sober response to his critics merely highlight the fact that no one seems to disagree about anything but how best to speak the truth.
Mr Klein writes:

Ending discrimination against sick people raises premiums for the healthy but lowers them for the sick. Reducing discrimination against old people raises premiums for the young but reduces them for the old. Regulating insurance products raises prices at the low-end of the insurance market but cuts costs for people who actually get sick and need insurance that actually covers illnesses. Pumping a trillion dollars in subsidies hugely cuts costs for the poor. Encouraging competition between insurers should reduce costs, though that's dependent on it working. The individual mandate should reduce average premiums by bringing younger, healthier applicants into the market.

So, yes: if you are older, but too young for Medicare, or if you have pre-existing conditions, you're very probably going to do better buying an individual plan under Obamacare. And, yes: if you are healthy, young and shopping on the individual market for insurance,Obamacare *certainly* means you will pay more. Obamacare's

champions like to take the edge off this fact by disparaging the basic level of insurance provided by inexpensive catastrophic policies. As Mr Krugman puts it, "these plans are cheap not just because they're only available to the very healthy but because they don't provide much insurance". Which is to say, the young and healthy will experience some "rate shock" at the Obamacareexchange not only because they will be subsidising those with a much higher cost of care, but also because they will be required to purchase more coverage than they might want or need.

Nobody actually disagrees about any of these facts, as far as I can tell. So why not be frank about the fact that Obamacare is going to stick it to the young and healthy on the individual market?

The critical question has to do with the Obamacare's effect on *average* premiums. The policy was sold to the public, insofar as the public actually bought it, on the grounds that it would not tend to make insurance on the whole less affordable. The *idea*, as Mr Klein expresses it, is that "the individual mandate should reduce average premiums by bringing younger, healthier applicants into the market".
Do you feel the tension?

If the cost of insurance for the young and healthy rises, are they more or less likely to buy it? Less likely. Obviously. That's why there's the controversial individual mandate. However, the enforcement mechanism for the mandate is fairly toothless. That adds up to trouble. Mr Cannon writes:

[H]ealthy consumers are the key to the entire enterprise. They are the ones who are vulnerable to rate shock. If they think the premiums are too high, they will pay the small penalty and wait until they are sick to buy coverage. If that happens, premiums will climb higher, more healthy people will drop out, and Obamacare will cause health insurance markets to collapse. Obamacare supporters are in a near-panic that young, healthy people won't sign up for coverage, and with good reason.
Mr Roy concurs:

The fact that Obamacare dramatically raises premiums on young people is a big deal, because the majority of uninsured people are young. It's the fact that insurance is already so expensive that leads so many young people to opt out. They're perfectly healthy; they don't have a lot of money; but they're being asked to shell out thousands of bucks for policies they won't use. And Obamacare's solution to this problem is...to force them to pay more?

But what about Obamacare's subsidies! "Those subsidies are the gamechanger in this market", Mr Klein says. He goes on:

Absent them—and arguably absent the individual mandate—these rules would simply shift costs around. They would help older and sicker applicants at the expense of younger and healthier ones, and if they drove younger and healthier folks out of the insurance market, they'd hurt everybody. But a trillion dollars in subsidies helps a lot of people buy insurance. And most of those people are, surprisingly, young and healthy.

This is Mr Klein's answer to Mr Cannon's death-spiral scenario: there will be subsidies! Is it convincing?

It's not so easy to say; Obamacare is hard to understand. But let's give it a shot. The subsidy takes the form of a tax credit meant to limit the percentage of annual income spent on the purchase of insurance. The tax credit, if there is one, can go straight to the insurer at the time of enrollment, so it can reduce the price pretty directly. There's no way to think all this through in the abstract, so meet Nicole. Nicole is a healthy 25-year-old freelance illustrator making $30,000 a year. She is presently uninsured due to cost. How can she be expected to behave under Obamacare? Taking into account Nicole's subsidy, she'll be able to buy the least expensive "Bronze" plan on an exchange for $1,919, according the Kaiser Family Foundation's subsidy calculator.

Look, that's not great. After going uninsured for a spell, about a year ago I signed up for a catastrophic plan (found through the Freelancer's Union) that cost me about $100 a month. I was...older than 25. Anyway, it's not always easy to get by on $30,000 in places with high rents, so one can imagine why Nicole might opt to go uninsured. But what about the non-compliance penalty under the individual mandate? Won't it coax her into enrollment?

Over the next two years, as the penalty scales up, it's pretty clear that Nicole would be smartest to pay the initially meagre fine and not sign up for insurance unless she comes down with something expensive. (No exclusions for pre-existing conditions!) But what about in 2016, when the non-compliance penalty is finally fully unfurled? That will be the greater of $695 per uninsured person, or 2.5% of household income over the filing threshold, which is not yet set, but this year was about $10,000 for individuals. So in Nicole's case, that's 2.5% of $20,000, which is only $500. So she's on the hook for $695. For Nicole in 2016, then, the difference between going uninsured and getting a Bronze plan is $1,224, which is just a touch more than I recently paid for a cheap catastrophic plan. If America's Nicoles are going without insurance due to cost, they're not going to be induced to get it under Obamacare. If the programme is going to bring down the cost of an average policy by goading the likes of Nicole into the risk pool, it needs a bigger carrot, stick or both.

I don't know what part of America's young, healthy and uninsured will find itself in a situation akin to Nicole's, but it would seem there's some reason to worry that the programme will not function as promised—especially when most of those eligible for subsidies don't know it, and surveys show that nearly "two-thirds of Americans who currently lack health insurance don't know yet if they will purchase that coverage by the Jan. 1 deadline set by the ACA". In any case, it is not at all clear that Obamacare's subsidies and mandate penalties are sufficient in size to prevent a situation in which the rules of the law "simply shift costs around", or to prevent a cost spiral that would drive the young and healthy out of the market and, as Mr Klein says, "hurt everybody". Nobody wants that. Of course, advocates of alternatives to Obamacare, such as Messrs Roy and Cannon, want to create a felt need for an alternative, so you can count on them to trumpet the weak spots of the policy's design. And, naturally, advocates of Obamacare want it to have a chance to work. But do they believe it really will work, once it fully rolls out? That's what has me a little puzzled. If the economic logic of the programme's incentives is sound, why do Obamacare's defenders seem wary of spooking Nicole?