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Before McCain Helped Save Obamacare, He Championed a Free-Market Revolution

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John McCain (R-Az) garnered high praise across the aisle from Chuck Schumer (D-NY) and a got a bashing from President Trump, for voting to kill the Republicans' two last-ditch assaults on the Affordable Care Act. Despite all the clatter surrounding the Arizona Republican's dramatic stance, virtually no one in the media even mentioned that the Senator who helped save Obamacare ran for president as a daring revolutionary bent on moving the healthcare market in precisely the opposite direction.

In short, the McCain plan of 2008 was the most radical, free-market-focused platform championed by either a presidential contender or advanced in high-profile legislation in recent decades. It's also the best. That the recent Republican bills contain almost none of the McCain's then-bedrock principles shows how far the center-of-gravity in Congress has shifted towards preserving today's complex, government-centric system, and away from solutions that put the customer in charge. In the future, reform that works needs to incorporate a big portion of McCain's bold manifesto.

Given today's far narrower debate, the McCain plan sounds almost simplistic and naive. He aimed at creating the same kind of market for healthcare that fosters competition and gets consumers shopping for everything from PCs to cars. The target was to substantially lower prices and tame the disastrous escalation in costs that swelled the ranks of the uninsured and promised a future of disastrous debt and deficits. As McCain stated in a magazine article from the fall of 2008, "The biggest problem with America's healthcare system is that it costs too much, and they way inflationary pressures are built into it. [Consumers] need to be in control of their own dollars."

The centerpiece of McCain's proposal was eliminating the "employer exclusion," the tax break companies receive for providing health benefits to their workers. The exclusion enables companies to buy a lot more healthcare for employees than they could purchase with their own after-tax dollars. As a result, corporations provide lavish, costly packages heavily subsidized by taxpayers, including those who didn't get the subsidies at all. Employees mostly didn't know it, but to this day, a big chunk of their compensation kept their raises puny and went instead to platinum-plated coverage.

The exclusion is extremely regressive, since higher-paid employees tend to receive the richest packages. It also discriminates against folks who are self-employed, or work for small outfits that don't offer benefits, since they're obligated to buy insurance with after-tax dollars, while big company employees receive big subsidies. In fact, the employer plans are more like an open-ended benefit than anything resembling regular insurance that protects people against catastrophic events. As a result, people covered by their companies seldom shop for bargains, or are even aware of what their employer is paying for checkups or angioplasties. The combination of a system where "somebody else pays" and "prices are invisible," according to the CBO, makes overall healthcare spending far higher than it would be without the gigantic tax break.

The McCain plan took the bold course of making employer-provided healthcare taxable income. In exchange, employees would have received refundable tax credits of $5000 per family or $2500 per individual for purchasing insurance. That money went to everyone, whether they worked for a company providing benefits or one not offering coverage, or the unemployed. Hence, it put all Americans on the equal footing by providing the same aid for people benefiting from the employer-provided coverage as those in the "individual" market paying the full premium with after-tax dollars.

The policies purchased with those credits would also be fully portable, meaning that folks could keep them if they changed jobs. That innovation would have greatly improved the flexibility, and productivity, of America's labor market, by allowing workers who refrain from switching to jobs where they'd perform better just to keep their health benefits.

Here's how the proposal would have worked in practice. Say an employee earns $100,000 a year, and the company contributes $9000 towards a family plan costing $12,000. Then, as now, the employee—assuming a 33% federal tax bracket—could buy only $6000 in insurance if they received that $9000 in direct pay. So once again, the employer can buy a lot more insurance, at the same cost to the company, than the employee could buy if those dollars went into their paycheck. Under the McCain plan, the employee would get the $5000 credit; at first glance, that seems like a bad deal since he or she is now receiving a $9000 contribution from the employer.

Here's where the shift turns tectonic. The employer would no longer have an incentive to pay for coverage at all. Instead, because labor markets are highly competitive, it would hand the employee what it now pays for healthcare by raising the employee's salary by $9000. That employee would then have an extra $6000 in after-tax income, plus the $5000 credit, for a total of $11,000, to purchase a policy.

But it's unlikely that consumers in this brave new market would buy the kind of costly, low-deductible policies typically provided by employers. Instead, they'd tend to choose real insurance, in the form of plans that cover them for the big stuff, but require the customer to pay for routine procedures. McCain linked the plan with enhanced Health Savings Accounts, so that folks could roll the excess of the credits plus extra income over and above their premiums, along with any extra cash earmarked for healthcare, into HSAs. Those HSA contributions would be tax-free. They then could use that money to pay for exams, pre-natal care, and other everyday medical costs. According to the then-McCain solution, that transformation would have spawned new generations of price-conscious shoppers for healthcare.

The radical proposals didn't end with banishing the employer exclusion. Indeed, they sound absolutely shocking by today's standards. The McCain plan permitted consumers to buy policies across state lines, creating a national insurance market. It didn't require insurers to accept folks with pre-existing conditions, and allowed them to charge customers of different ages and medical conditions premiums that reflected their full costs, as opposed to the in many states that mandate "community rating." Under community rating, carriers must offer the same premiums to everyone; hence, the young and healthy are obliged to heavily subsidize the old and sick. Forcing the 20-and-30-somethings to pay $5000 a year for insurance that costs $1500 in a non-community rating state is a major reason so many dropped coverage, helping create today's tens of millions of uninsured.

In fact, eliminating community rating, and the mandate to cover pre-existing conditions—without fully addressing the consequences—was the major weakness in the McCain blueprint. That weakness invited a bashing in the press and from prominent think-tanks. It was obvious that a 30 year old in a community rating state like New York would buy a far cheaper policy in Pennsylvania, where carriers were free to charge according to cost. The rub was that insurance pools in New York would shrink, rates would jump, and the old and sick could no longer afford coverage, potentially causing a national catastrophe. McCain attempted to counter the criticism by advocating big federal subsidies for "high-risk" pools for folks with cancer or Parkinson's, administered by the states. But his proposals weren't specific or generous enough to allay the fears of voters.

In recent years, pieces of the McCain plan have surfaced in Republican proposals. Senators Jeff Flake (R-Az) and Congressman Dave Brat (R-Va) a new breed of HSAs that allow unlimited tax-free contributions. Senator Rand Paul championed a similar proposal. The first narrow-repeal bill also would have allowed purchasing insurance across state lines.

But the Republicans never again proposed ending the employer exclusion. The policies forcing the young and healthy to subsidize the old and poor, enshrined in Obamacare, and hence forcing them to vastly overpay, have basically remained in the two recently-defeated bills. "The Republicans need to regroup, and have an intellectual debate," says Michael Tanner, an economist with the libertarian Cato Institute. "Their bills don't deal with the third party payment problem the way the McCain plan did. Unlike his, their plans had no theme. It won't happen in 2018 because it's an election year. But in 2019, the Republicans should form an entirely new plan."

That platform should look back to what John McCain proposed in 2008. It failed, but it was perhaps the finest hour in public life for this bold maverick. His vision deserves to rise again.