Reflections on the Massachusetts Election

Remarks of J. Thomas Rosch*
Commissioner, Federal Trade Commission

at the

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I.

My main thesis this afternoon is that Scott Brown saved the Democrats from themselves. There are a number of reasons why that is so. First, the House bill’s embrace of the public option—far from guaranteeing there would be competition in the insurance market—virtually guaranteed there would not be competition. Why?

Economics 101 teaches that real competition exists only when the low cost provider—the solvent provider with the lowest costs—can prevail. “Costs” refers not just to the costs of providing goods and services, but also to the costs of capital and taxes. If and to the extent a public option (or a quasi-public option) gets subsidized or free capital from the federal

* The views stated here are my own and do not necessarily reflect the views of the Commission or other Commissioners.
government (as happened repeatedly during the recent financial crisis) or doesn’t have to pay taxes (because it’s wholly or partially tax exempt), there’s a thumb on the scale in its competition with private insurers who don’t get those breaks. The government-subsidized insurer’s costs will always be lower than the costs of any participant who must compete without government support. Real competition cannot and will not occur.

The Senate bill’s embrace of a wholly or partially tax-exempt alternative would not right the ship. To be sure, it is better than an alternative that involves the government in providing subsidized or free capital. But insofar as that alternative would still be tax exempt, the alternative would have a competitive advantage over private insurers who are not tax-exempt. Indeed, the alternative is intended to put the pressure on private insurers in the market in order to cap their prices and terms.

Second, because that is so and also because of the Senate bill’s tax on “Cadillac” health plans, it is impossible over the long run (and maybe over a shorter time horizon) to fulfill the commitment that every American who is satisfied with his or her insurance can keep it. Why?

That promise assumes that today’s private insurers continue to exist. If a public option or a tax-exempt alternative exists, it is hard to see how all private insurers out there (except possibly the Blues and other private insurers that currently enjoy monopoly power or that compete in local markets that are duopolies) could continue to exist for very long; over the long run, they would be run out of business by the subsidized alternative. And even over the short or medium run, “Cadillac” plans may be taxed out of existence.

As a result, some insureds would surely have to buy different health insurance or health insurance from a different insurer. That insurance may or may not be as satisfactory to them as what they have now.
This flaw is exacerbated by provisions in both bills that would impose taxes a number of years before health care coverage is expanded in order to create the impression that universal care will not bust the budget. Those provisions insure that Americans will feel the pain years before the see the gain. That might have been good short-run politics (in terms of getting a 60th vote in the Senate) but it’s hard to see how that’s good long-run politics, much less sound public policy.

Third, the options adopted in the House and Senate bills—far from “bending the curve” (reducing overall expenditures on health care in America)—would seem to guarantee the curve would not be bent. Why?

Economics 101 also teaches that if and to the extent an alternative is subsidized, it will have less of an incentive than unsubsidized insurers have to keep the lid on hospital, physician, and pharmaceutical costs. The demand for insurance services is, after all, what the economists call “derived demand.” That is to say, the demand for insurance services depends in the end on the demand for the services of health care providers like hospitals, physicians and pharmaceutical companies.

To cap the costs of those health care providers, private insurers currently can and do “steer” insureds to health care providers that are willing and able to cap their health care rates. Private insurers use various steering mechanisms like copays and deductibles to do that. In the case of pharmaceuticals, they also use formularies. It is not at all clear that subsidizing a competitor—and thus sapping its incentives to use such steering mechanisms—is the only way (or the best way) to “bend the curve.”

Fourth, the House bill threatened to create one of the biggest wealth transfers in American history. Why?
To begin with, so-called “universal health” systems in all countries must ration health care in one way or another because they simply can’t afford to give everything to everybody. Some countries do it by denying expensive therapies to some individuals (generally the elderly, as in some European countries). Some do it by requiring individuals to stand in line (as in Canada, where the watchword is that you can have your baby delivered under the system but you may have to wait for 12 months to do it). In America we’ve traditionally rationed on the basis of means: he or she who has had the means to pay for the most expensive treatments has gotten them; he or she who lacks those means has not.

Under the House bill, in addition to this traditional form of rationing on the basis of means, high income individuals would also be taxed regardless of their health care purchases. We have been told that’s fair (or that those individuals are willing to make the sacrifice)—that’s what the last election was about. Maybe so, but maybe not. Certainly the amount of that sacrifice was not defined before the last election so that may come as a surprise to all of those taxpayers.

Nor has the cost of providing universal health care been adequately defined upfront. The “Basic” and “Emergency” components of universal healthcare are still amorphous. But you can bet that those packages will be very rich. Recent history has shown that broad coverage is politically easy to give away but it is mighty hard to take away. States like Oregon and Tennessee have learned that the hard way as they’ve tried to rein in so-called “universal health care” costs. As matters now stand, the bills ask Americans to buy a pig in a poke.

Fifth, the assertion that there’s no chance that grandma (or grandpa) will be denied the health care she or he may need in a ripe old age is severely compromised under the bills. Why?
Republicans are in part responsible by focusing on the provision of the House bill that would pay for end-of-life counseling and labeling it as a provision for “death squads.” That was absurd, and most Americans thought so too. But what isn’t absurd—and what is contemplated—is that decisions about what health care will be provided universally and what will not will be made by an “expert” panel tasked with deciding what therapies are sufficiently cost-effective to be included in packages supported by the federal government. Those decisions will not be immune from political pressures. Consider what happened with the “mammogram” recommendation last fall; the Administration disowned it before the ink was dry.

To date it’s contemplated that panel will make decisions for the Medicare program (in order to wring some cost savings out of Medicare to help pay for universal coverage). That would put seniors squarely in the panel’s sights. If the panel were to determine what health care should be included in the Basic and Emergency care components of the coverage offered to the millions of new insureds to be offered universal coverage, that might expand those affected by the panel’s decision to younger people who are currently not insured, but the panel’s decisions would affect the elderly who are currently uninsured as well. The only way to avoid that result would be to include all health care in the universal coverage package, and that would be prohibitively expensive.

These are only some of the macro flaws in the House and Senate bills. This discussion ignores what Senator Webb rightly described as the extraordinarily unseemly “process” used to develop and try to mesh the bills.

It ignores, for example, the deal that was cut with Senator Ben Nelson pursuant to which Nebraska was exempted from Medicaid costs for several years (and, incidentally, Medicaid does pay for health care provided to illegal aliens, as anyone who has been to an emergency ward
recently can attest). And the deals that were cut between pro-lifers and pro-choice advocates about abortion, which was supposed to be off the table in this legislation. And the deal that was cut with organized labor to give it an 8 year exemption from taxation of employers offering “Cadillac” plans to union employees—a deal whose purpose and effect was plainly to put non-union shops at a competitive disadvantage.

In a nutshell, then, what happened in Massachusetts on January 19 pales by comparison with what would probably have happened in November of 2010 if these bills were enacted into law. Americans who are surprised and disappointed by politicians do not rebel except at the ballot box. But that is what probably would have happened 10 months from now.

II.

I’ve been asked to comment on the remarks made this afternoon by representatives of the American Hospital Association, the American Medical Association, the pharmaceutical industry and the insurance industry.

I’ve known several of those representatives for several years, and I like and respect them all. I do not impugn their motives or their feelings or the motives and feelings of the organizations they represent. In fact, in my prior life as an antitrust trial lawyer I represented a number of hospitals, doctors, pharmaceutical companies and insurers, and I’d probably feel the same way they do if I’d spent a year of my life on these bills. But as you evaluate whether the collapse of these bills will have the dire consequences they describe, please understand that each of these groups had a lot to gain from the enactment of this legislation. As health care providers, hospitals, doctors, and pharma, as well as the Blues and other big, well established insurers, would all have benefitted mightily from universal health care: it would have expanded exponentially the universe of patients whose health care was paid for by private insurers (or in
the case of the insurance industry, the universe of insureds for those insurers). It is therefore not surprising that they supported this legislation.

III.

I’ve also been asked to comment on the remarks of Josh Soven, as the representative of the Antitrust Division of the Justice Department.

To begin with, I’ve also known and respected Josh for a number of years. The crux of his remarks is that the health insurance market in the United States is not competitive and that it would be better for America if it were more competitive. I agree wholeheartedly with Josh on both points. But I would make three quick points in return.

First, the makeup of the “Basic” and “Emergency” components of universal health care could have ended up being beyond the reach of every insurance provider except the Blues and the big, established insurers. Those are the very insurers who enjoy monopoly or near-monopoly power in the local markets they serve. So the legislation could have ended up cementing their positions.

Second, Josh neglected to mention the major reason why the insurance market is not competitive in America. It is not because the Antitrust Division has been asleep at the switch in evaluating or challenging insurance mergers. It is because most of the ex post antitrust enforcement has been done by the states under the McCarran Ferguson Act, so enforcement of the antitrust laws in America is largely a patchwork quilt, with some states doing a good job, and others doing a bad job. The House bill contained a reform of the McCarran Ferguson Act, but it was largely a sham. It would have prohibited hard core price-fixing, which is not widely practiced by insurers, if they engage in that kind of conduct at all. It would not have affected the kinds of information-sharing or other anticompetitive practices that are the real problem.
Third, real remedial legislation should focus on the root causes of the problem. It should, among other things, provide for transparent consumer education; it should prescribe what can be awarded in malpractice lawsuits as well as what terms can be included in private insurance policies; and it should repeal the McCarran Ferguson Act so that the antitrust laws can and will be vigorously enforced. Both Republicans and Democrats, in other words, should “coalesce” around the parts of the legislation and Republican proposals about which there can be agreement, as the President has suggested. Those things may not be dramatic. But they will better serve America than a greatly flawed grand plan.