A Fundamental Misconception in the Health Insurance Debate

On Feb. 25 2010, President Obama held a health care "summit" meeting with congressional leaders of both parties. Rep. George Miller, the key Chairman of the House Education and Labor Committee, opined the following theory of insurance markets, as reported in USA Today's running online summary:

12:20 p.m. **-- Rep. George Miller, D-Calif., says it's not fair to deny people coverage for pre-existing conditions, including some that have no impact on current health. Requiring all people to buy insurance -- including healthy people -- would help insurance companies cover high-risk customers.**

The ensuing remarks indicated that this view is shared by the President. It may surprise some of you to learn that this is most assuredly NOT the way that well-functioning insurance markets are suppose to work. A well-functioning insurance market permits individuals and organizations to spread <u>similar</u> risks *among* a broader group. For example, the well-functioning market for life insurance (nobody at the Health Care Summit complained about life insurance) charges far higher rates for new policies taken out by the elderly than it does for new policies taken out by young breadwinners who have started families. This is because the risk of death during the policy period is far lower for the latter, and hence it is both efficient and fair to charge lower rates to those younger insureds, and higher rates to the older insureds. In a well-functioning market for life insurance, both young and old pay rates proportional to their actuarial risks. Even with that, many young people refuse to buy life insurance at all, preferring to either spend the would-be premiums on much needed goods (e.g. starter housing) or to help meet their savings goals. Few question their right to do so, but in any event, younger and/or healthier individuals would not be expected to subsidize life insurance rates for the elderly and/or other more risky groups -- unless government pricing mandates forced insurance companies to do so. The same could be said for property and casualty insurance, where the tables are turned: the younger, more accident-prone drivers should and will pay higher rates for auto insurance than will middle aged, less accident-prone drivers, unless government mandates force something else.

Relatively few members of the public or body politic believe these situations to be terribly unfair. But Rep. Miller's comments, if extended from health insurance to life insurance, imply that young people (who on average are healthier than the elderly) should be forced to buy life insurance, in order to help insurance companies cover the cost of elderly (i.e. higher risk) customers. When it comes to the risk of death, being elderly is what Rep. Miller would have to call a "pre-existing condition". The only way to "help insurance companies cover" those "high-risk customers" would be for them to overcharge younger people for life insurance, and the only way to force younger people to pay those unfair rates is to require them to buy insurance. In this Rep. Miller is correct, but is it fair to all concerned? If not, why is it more fair when the words "health insurance" are substituted for the words "life insurance"? Make no mistake: his policy will overcharge the population of younger, observably healthier folks to help pay the costs incurred by the more observably unhealthier (typically older) population.

One could argue that this reasoning is particularly egregious, given that our costly social insurance (i.e. Social Security) already operates on the similarly shaky principle advocated by Rep. Miller and his ilk -- that today's younger population should subsidize costs for today's older population. Both scholarly and political commissions have concluded that the ongoing demographic shift has turned the foundation for this scheme into a financial house of cards, yet now we find Rep. Miller and many others proposing to implement yet another massive, intergenerational cross-subsidy scheme. The unprecedented huge growth in deficit spending is another policy that will force young people to eventually overpay for government programs that benefited others in addition to themselves.

In summary, it behooves us all to grasp the fundamental principle of properly operating insurance markets: people must pay rates proportional to their actuarial risks. Risk sharing is supposed to occur *within* each risk class. In that case, there will be no spreading of risks *across* groups with *different* actuarial risks. Doing anything else forces one group to cross-subsidize another. As a group, young people have already been burdened enough by cross-subsidies implicit in social insurance and deficit spending policies. Why add another?