



**PRINCIPLES FOR
BUILDING BETTER
HEALTH INSURANCE**

Chris Pope
Senior Fellow

Contents

Executive Summary.....	3
Individual Control of Insurance	4
Insurance that Carries Across Jobs	4
Discounts for Continuous Coverage	5
Directly Assist the Uninsurable	6

Executive Summary

Even before Covid-19 shook the nation and its economy, Americans were feeling increasingly discontent with the rising cost of health insurance, the risk that they could be left with inadequate coverage, or the prospect of being unable to afford insurance altogether. To set things right, policymakers should advance reforms adhering to four key principles:

- ✓ **Put individuals in control of insurance**, so that they can purchase cost-effective alternatives to group plans that are not focused on giving them value for money.

- ✓ **Make insurance portable across jobs**, so that people can keep their preferred plans as they move between employers and across the country.

- ✓ **Discounts for maintaining continuous coverage**, to give healthy people a reason to sign up before they get sick, provide an incentive to avoid lapses in coverage, and reduce the average cost of the insurance risk pool.

- ✓ **Directly assist the uninsurable**, by structuring subsidies straightforwardly as an entitlement, rather than forcing insurers to redistribute by overpricing insurance for people who sign up before they get sick.



Individual Control of Insurance

More than a decade after the Affordable Care Act (ACA), the cost of health insurance remains a major concern for voters from both political parties. The average cost of family coverage provided by employers soared from \$5,791 in 1999 to \$20,576 in 2018. As a result, the share of non-elderly Americans receiving health insurance from their employers fell from 68% to 58% over the same period. In 2018, only 7% of Americans purchased health insurance for themselves.

The purchase of health-care benefits by employers worked reasonably well for many decades following World War II—funding the upgrading of the nation’s medical capacity and covering the bulk of the population. To encourage its provision, policymakers of both parties exempted employer-sponsored health-care benefits from income and payroll taxes. But this entrenched an arrangement whereby employers purchase health-care benefits for staff, thereby making corporate human-resources departments—rather than patients—the customer whose concerns and priorities are most closely attended to.

Large employers usually have staff living all around a metropolitan area, so their health-care plans must cover hospitals and doctors serving a variety of localities. Medical providers know this and can insist on generous reimbursement arrangements in return for inclusion in networks. Hospitals then compete for patients and top physicians by upgrading equipment and facilities—knowing that insurers will generously reimburse them—which drives costs spiraling upward through a medical arms race.

Patients who need treatment for serious medical conditions want all-inclusive simplicity and peace of mind from plans that cover a few select providers, not broad and messy networks with risks of surprise bills. Putting individuals in control of the purchase of insurance would empower plans to serve their needs more directly and cost-effectively.

Insurance that Carries Across Jobs

In 2018, 89% of privately insured Americans received health insurance from their employers. Not only are some individuals dissatisfied with the health-insurance plans that are chosen for them by HR departments, but those who *do* like their plan are at risk of losing health-care coverage if their employment circumstances change.

As unemployment claims soared from 1.7 million in March to 24.9 million in May 2020, millions of Americans lost their primary source of health-insurance coverage in the middle of a pandemic. This left them having to navigate a complex array of flawed or expensive alternative options (COBRA, spousal coverage, ACA, short-term insurance, or Medicaid), for which they may or may not be eligible because of idiosyncratic personal circumstances.

Employer-sponsored health insurance works poorly for those in precarious employment situations—compounding the pain for those who lose their jobs and creating a significant risk for anyone considering starting a business. This is also proving increasingly problematic for small businesses. In 2019, while 99% of firms with more than 200 workers offered health insurance, only 47% of those with fewer than nine employees did so.

ACA sought to equalize the tax treatment of individually purchased insurance and employer-sponsored insurance by establishing a tax on high-cost employer-sponsored plans. But this policy (which Congress has repealed) would only have made employer-sponsored coverage less generous, without improving individually purchased coverage. A better approach is to extend the tax exemption to coverage that individuals purchase for themselves. This would help achieve the first two principles of reform: putting individuals in control of purchasing their health insurance; and enabling them to retain coverage across jobs. A recent regulatory reform, to allow employers to place pretax funds into Health Reimbursement Accounts for individuals to purchase their own insurance, should do much to eliminate this obstacle to widespread individual control of insurance.

Discounts for Continuous Coverage

Although control over the choice of health insurance potentially allows individuals to purchase coverage that meets their needs and priorities at a better price, ACA's pricing regulations have thrown the individual market into chaos.

In order to extend affordable coverage to individuals with preexisting conditions, ACA required insurers to sell plans to individuals at prices without regard to their medical risks. This discouraged healthy people from purchasing coverage, while only those with high medical risks signed up—causing insurers to be hit with massive losses and most carriers to exit the market. Those that remained hiked premiums by an average of 105% in the four years following ACA's enactment.

ACA advocates believed that the legislation's individual mandate penalty would stop people from waiting until after they got sick before purchasing insurance. But the penalty was assessed according to one's income and ability to pay. Since those who lack employer-sponsored insurance are a disproportionately low-income group, only 4% of those who failed to purchase insurance in 2016 were subject to a penalty of \$1,000 or more.

The U.S. should rely on carrots, rather than sticks, to fix the individual market. Enrollees should be allowed to receive discounted coverage if they sign up before they get ill and subsequently maintain continuous coverage as they get older and sicker. When Australia gave people the opportunity to receive such discounts for maintaining continuous coverage, it increased enrollment in private health insurance from 30% to 45% of the population. The value of the discount for signing up early compounds as long as one is enrolled, strengthening the incentive for people to retain coverage.

Long-term adherence to insurance plans helps spread up-front marketing, administration, and underwriting costs associated with enrollment over several years, and it rewards insurers for investments in individual health such as preventive care and drug therapies.

Directly Assist the Uninsurable

Expanding the affordability of insurance and adherence to plans by healthy individuals would reduce the number of individuals who become uninsurable by developing preexisting conditions during gaps in coverage. But some would still remain who are unavoidably uninsurable and would need public assistance.

Some 8.6 million of the 12.5 million Americans enrolled in the individual market currently receive subsidies that automatically expand to guarantee coverage at premiums limited as a share of income. These subsidies, then, effectively function as an entitlement in disguise—but they are not funded like normal entitlements. Instead, the cost of covering those with preexisting conditions is partly funded through inflated premiums imposed on individuals who sign up before they get sick.

It is right to preserve a safety net for individuals who are uninsurable. But this should be subsidized entirely through direct public spending spread over all taxpayers, rather than by a regulatory tax that falls narrowly on the purchase of health insurance through the individual market.

For further discussion, see: “Fixing Private Health Insurance”
in the Summer 2020 issue of *National Affairs*.



MANHATTAN
INSTITUTE