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POLICY NOTE

The problem with the Obamacare exchanges is adverse selection, not cost-reduction subsidies

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Key Findings

1. The Obama Administration did an end-run around Congress and directed money from the Treasury to provide tax credits to the Obamacare exchanges.
2. The funds for these cost-reduction subsidies were never appropriated by Congress. The Trump Administration stopped these unauthorized payments.
3. The fundamental problem in the exchanges, however, is not the withholding of the cost-reduction subsidies. The Obamacare exchanges suffer from adverse selection.
4. Adverse selection has happened since the exchanges began in 2014, long before the issue making unauthorized cost-reduction subsidy payments out of the Treasury arose.
5. The debate over Obamacare will continue, but cost-reduction subsidies are not the core problem, they are simply prolonging the inevitable collapse of the Obamacare exchanges.

Introduction

The Obamacare law provides tax credits for people earning up to 400 percent of the poverty level to help them purchase health insurance in the exchanges. The law also gives lower-income people additional money, so called cost-reduction subsidies, to purchase health insurance within the exchanges.

The funds the U.S. Treasury is paying out for these cost-reduction subsidies were never appropriated by Congress. The Obama Administration, however, did an end-run around Congress and withdrew the money from the Treasury unilaterally. The Republican House of Representatives sued the Obama Administration and won. The objection of leaders of the House of Representatives was less about health care policy and mostly about preserving the people's powers of elected representation under the Constitution.

The Constitutional way to spend public money

Article 1 of the Constitution states quite clearly that, "No money shall be drawn from the Treasury, but in consequence of appropriations made by law." The case was appealed and now resides in the appellate court. Subsidy payments continue until the appeal process is completed and the courts make a final decision.

In a way, though, the voters have already resolved this conflict by changing administrations. The Obama Administration, which initiated the subsidy payments out of the Treasury, no longer exists, and the current Trump Administration could simply drop the lawsuit and stop paying out the unauthorized cost-reduction subsidies.

Adding to the deficit

The Congressional Budget Office recently weighed-in on eliminating the subsidies. Its most publicized finding was that withholding the funding would add $194 billion to the federal deficit over the next ten years.

This number is based on the speculation that premiums in the exchanges would increase and that the increase in tax credits would drain billions off the federal budget. CBO is often wrong in its estimates, because markets often don't react to a major policy change the way congressional number-crunchers expect.

The problem of adverse selection

In any case, the fundamental problem in the exchanges is not the withholding of the cost-reduction subsidies. The Obamacare exchanges suffer from adverse selection. Insurance premiums in the individual market, both inside and outside the exchanges, are rapidly rising because young, healthy people are being priced out of the market. A higher percent of older and sicker individuals are signing up, which drives up costs, and makes the price of insurance even less attractive to healthy people.

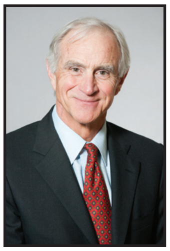
This adverse selection has happened since the exchanges began in 2014 under the Obama Administration. The death spiral of the exchanges began long before the issue making unauthorized cost-reduction subsidy payments out of the Treasury arose.

When the exchanges started, the Obama Administration estimated that at least 40 percent of enrollees would need to be young and healthy to provide the premiums needed to fund coverage for older, sicker enrollees. Since 2014, the level of young and healthy enrollees in the Obamacare exchanges has never topped 28 percent. This shortfall points to the fundamental flaw in Obamacare: trying to force people to pay more for coverage they don't want doesn't work.

In fact, most social policies based on government coercion don't work, because people will always try to make decisions, especially in health care, that are best for themselves and their families, not because of what is politically convenient for the current Administration in Washington, D.C.

Conclusion

The debate over the failures of Obamacare will continue, but cost-reduction subsidies are not the core problem. They are simply prolonging the inevitable collapse of the Obamacare exchange marketplaces.



Dr. Roger Stark is the health care policy analyst at WPC and a retired physician. He is the author of two books including *The Patient-Centered Solution: Our Health Care Crisis, How It Happened, and How We Can Fix It.* He has also authored numerous in-depth studies on health care policy for WPC, including *Health care reform: lowering costs by putting patients in charge.* Over a 12-month period in 2013 and 2014, Dr. Stark testified before three different Congressional committees in Washington DC regarding the Affordable Care Act. He completed his general surgery residency in Seattle and his cardiothoracic residency at the University of Utah. After practicing in Tacoma he moved to Bellevue and was one of the co-founders of the open heart surgery program at Overlake Hospital. He has served on the hospital's governing board.

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