Letter from America —

Adverse selection emerges from the weeds

In his latest Letter from America, Angus shows how the opposition to healthcare insurance draws heavily on the concept of moral hazard while being curiously blind to adverse selection.

Downton Abbey, the interminable British soap opera, is broadcast in the United States on public (non-commercial) television, and has provided it with its all time greatest hit. For viewers in the New York area, the showing is preceded by a sixty second commercial on behalf of New York (previously Columbia) Presbyterian hospital. The long-term political swing to the right and its hostility to public broadcasting has forced public television to abandon its longstanding policy of minimalist 'brought to you by' acknowledgements. One advertisement features the boxer Daniel Jacobs, a rising star in 2011 when he was brought down by a 'massive tumor that had wrapped itself around my spine'. But his doctor at New York Presbyterian 'aced it; they resurrected me, and resurrected my career' so that 'on August 9th, 2014, I became the WBA middleweight champion of the world'. The audience for public television in New York is well-heeled (the next ad is for Viking River Cruises), but likely contains few professional boxers, few who have a cancer wrapped around their spine, and very few who are free to choose their healthcare in the same way as they choose between Budapest and Bangkok for their Viking River cruise. The same can be said for the audience for the ad on the cover of the program for the Metropolitan Opera's current run of *Don Giovanni*, featuring a young woman 'told by doctor' that amputation of her legs was best, but who, thanks to the same hospital, now needs braces only for her teeth.

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Insurance encourages moral hazard...

Yet the hospital ads are indeed aimed at consumers, who are being implicitly incited to pressure insurance companies and employers to provide plans that cover treatment at NY Presbyterian. Each American hospital negotiates (secret) prices for each service with each insurer, setting discounts from their infamously extortionate 'chargemaster' prices, which people who do not have insurance — or adequate insurance — must routinely pay (or try to pay). The purpose of the ads is to keep those discounts smaller than those of its competitors, at which this hospital is reputedly very successful. *Downton Abbey* shows how falling land rents contributed to the fall of the British aristocracy, but is helping raise prices for US healthcare and creating great wealth among successful hospital entrepreneurs.

Market fundamentalists, who are well represented among the Republicans who currently control both houses of Congress as well as a majority on the Supreme Court, attribute the *Downton Abbey*/NY Presbyterian problem to the fact that the market for healthcare is undermined by moral hazard, by the overuse, overprovision, and lack of price discipline that comes with insurance, or at least with too much insurance. They believe that, if consumers bore all or at least a larger direct share of their healthcare costs-a favorite phrase is 'if they had more skin in the game' — market forces would bring down the cost of MRI machines, proton-beam scanners, and hip replacements, just as they have brought down the cost of flat screen televisions. Everyone would then be able to afford cheap, high-quality healthcare, just as everyone owns a smartphone, and insurance would cover only catastrophically expensive events. Such ideas are beguiling, and the scandal of high cost healthcare is clearly exacerbated by private insurance, as well as by the implacable opposition of providers, device manufacturers and the pharmaceutical industry (as well as the market fundamentalists) to the institution of the kind of evaluation that is done by the National Institute of Health and Care Excellence in the UK.

...but what about adverse selection?

For economists, adverse selection has always been central to discussions of health insurance. Yet, it has been hard to explain to the public. Politicians of the right, who so clearly understand moral hazard, seem (sometimes willfully) blind to adverse selection; people are fallible, but markets are not. On the left, during the primaries for the 2008 election, Hillary Clinton favored a 'mandate' that would require people to have insurance, a proposal that Obama denounced as unnecessary and (presumably) unlikely to appeal to voters. Adverse selection is one of those many issues where there is a large gulf between economists' and public understanding, where what appear to most people as beneficial policies, like not forcing people to buy insurance, are guaranteed to have unintended consequences.

During the primaries in 2008, the disagreement over the mandate was dismissed by the commentariat as an issue that was esoteric and so far 'out in the weeds' that it could have no possible importance in the contest. In the event, Obama won the primary and the election, his administration passed the Affordable Care Act, without a single Republican vote, and with the mandate. But cures for adverse selection are not so easily sold. The first potentially crippling challenge to the Act argued that it was unconstitutional for the federal government to require anyone to buy anything; Justice Scalia asked if the state could force people to buy broccoli. The Supreme Court decided in June 2012 — on a surprise vote by Chief Justice Roberts-that the mandate was not in fact a mandate, which five of the nine justices would have ruled unconstitutional — but a perfectly constitutional tax, something that the Obama administration had consistently denied, if only because it would have had consequences for the evaluation of the law and the likelihood of its passage. When Jonathan Gruber, the distinguished MIT economist, who had advised on the law (but was not a central architect), said that the law was deliberately obscure, that its lack of transparency was a political advantage which, given 'the stupidity of the American voter' was critical to its passage, he was only expressing something that many economists have often thought. He was only unfortunate to fall foul of one of today's omnipresent hazards, a hidden recorder.

Market fundamentalists believe that people should be free to choose to be uninsured or to buy any insurance that they like, including deceptive policies that are attractive only because most healthy people have no idea what hospitals will charge them. These policies were outlawed under Obamacare, so that some people had to give up insurance that (they thought) they were happy with. This interference with freedom of choice has been much criticized on the right, and was made worse by Obama's false claim that no one would have to give up their existing insurance. Yet the market fundamentalists cannot acknowledge adverse selection, because it means admitting that markets can fail. But they dare not give up the requirement (popular among both consumers and the industry) that prevents insurance companies from discriminating against pre-existing conditions. Just as adverse selection tortures economists who cannot get it widely and intuitively understood, so are the market fundamentalist politicians trapped between, on the one hand, their own beliefs that getting the government out of healthcare and healthcare regulation will bring down prices, increase access, and give people freedom to choose, and on the other hand, the demands of both the industry and consumers that no one be denied insurance because of pre-existing conditions. As a result, if the Supreme Court strikes down Obamacare this summer — an even bet at the time of writing — the Republican Congress is likely to push replacements that will be destroyed as adverse selection emerges from the weeds.

Secretary-General's Annual Report

The Secretary-General, John Beath, presented his final report to the Society's AGM at the University of Manchester on Tuesday 31st March.

I was appointed Secretary General of the Society in 2008 in succession to Richard Portes and so this is my seventh report to the membership. It is also my last report as I will be handing over the reins for running the Society to Denise Osborn at the end of June. I shall say a little more on that later. This is an important anniversary year for the Society. Although it is only 113 years since we received our Royal Charter and became entitled to call ourselves the Royal Economic Society, it is 125 years since the Society's predecessor, British Economic Association was founded and with it the *Economic Journal* established. I am particularly delighted that this year's Annual Conference has been built around the EJ's 125th anniversary — and in such a fascinating way — with fresh eyes looking at classic and path-breaking papers from that history and great praise is due to Rachel Griffith and the editorial team and to James Banks and the conference team for putting all of this in place. Of course, 2015 also happens to be the 125th anniversary of the Forth Bridge and it is pure, but happy coincidence that our new President is based in Edinburgh.

In my report last year I drew attention to our Society's emblem, the honeybee, and described the Society as a hive. I can report that this is no grumbling hive but a happy and healthy one. It continues to thrive and the sound coming from it is one of buzzing contentment! Underneath our emblem is a Latin motto: *Amor urget habendi.*