Health Insurance For Dummies

After watching his health care address to a joint session of Congress, it occurred to me that if Obama—the smartest person in the universe—doesn't understand the concept of insurance, there must be a substantial number of everyday Americans who might also need a little brush-up on the subject. Granted, the public schools have precious little time to teach anything remotely related to basic economics when teachers' days are filled with tributes to Che Guevara and excoriating those nasty white Europeans who brought evils like civilization and shoes to the American continent, but the topic of insurance can be covered quite quickly, it turns out.

To *insure* is to "protect against loss, damage, etc. with insurance. *Insurance* is "a contract binding a company to indemnify an insured party against specified loss." Although my dictionary is showing signs of age (its cover price is 75 cents), I suspect that those two terms have nevertheless not changed in *reality.*

In *perception*, however, it is a different story. And perception, folks, is why some say we have a "health insurance crisis." Convincing many Americans that we are in the middle of a crisis is how some prominent politicians—I won't mention any names—advance their big-government causes. *"Things are so bad that we need massive government intervention to fix everything!"*

Nonsense. We don't have a health insurance crisis. We have a *"people have forgotten how insurance works"* crisis.

You take out an insurance policy to insure yourself against a loss—*an unlikely, unanticipated, unexpected loss*. For example, you have car insurance to protect you in the event your car is damaged in an accident, destroyed by a falling tree in a storm, incinerated in a garage fire, or stolen by a thief. Those are all unlikely, unanticipated, and unexpected events. You hope your car will not be damaged, destroyed, or stolen. In fact, you hope you never have to rely on your insurance.

Car insurance "works" only because most cars are *not* destroyed or stolen. You may not like paying $1,000 per year to insure your $25,000 car. (Insert your own numbers if you prefer.) But $1,000 will seem quite reasonable if your car is destroyed or stolen.

Consider what your car insurance would cost if *every* car in America were destroyed or stolen each year. Clearly, insurance companies would cease to exist if they collected $1,000 in annual premiums from each of their customers and then had to pay out $25,000 in return to every one of them.

The same principle applies to homeowners insurance. You pay $1,000 per year to insure your $250,000 house against a disaster. Most houses do not burn down. Most houses are not robbed. Most houses are not struck by tornadoes. If every house in America were destroyed every year, your premium would certainly not be $1,000—it would be

$250,000! (Of course, no insurance companies would exist if the destruction rate were 100 per cent.)

Insurance “works” when you insure against *unlikely* events. The less likely the event, the cheaper the insurance. Homeowners insurance is cheaper than car insurance (unless you live in a flood zone or hurricane zone) because the chances of your house being destroyed are far lower than the chances of your car being destroyed or stolen. The key factor in the amount of insurance premiums is obviously the risk factor. Park your new Corvette in the street in a bad neighborhood and your car insurance will cost more than if you park your sedan in a quiet suburban garage. That is *not* the result of insurance companies cheating Corvette owners, it is the result of *probability factors*.

Again, insurance “works” when you insure against *unlikely* events. The more likely the event, the more expensive the insurance. You do not insure your car for the use of gasoline or oil, because stopping for a tank of gas or an oil change is *not* an unlikely event. It is a *routine* event. You do not insure your house against dirty windows or walls, because washing windows and repainting walls are routine events. No one with any common sense would expect her car insurance policy to pay for windshield wiper blades or brake pads. No one with any common sense would expect his homeowners policy to pay for kitchen curtains or a bathroom faucet.

Insurance works when you insure against *unlikely* events. If your car is stolen and the insurance company replaces it with a new one, your $1,000 premium paid for only a portion of that new car. The rest of your new car was paid for by those policyholders whose cars were *not* stolen. If your house is destroyed by a tornado, your new house is paid for by all the other policyholders whose homes were *not* destroyed. *That is the point of insurance: voluntarily spreading risk among many* so that individuals can avoid some (not all) of their pain.

Enter Obama, who was elected partly based on his claims that he would “address” the “health care crisis.” On September 9 he felt obligated to give yet another speech to push his plans—most of which are represented by a 1,018-page bill that Americans have come to understand is a monstrosity which will make their lives worse, not better.

Let’s examine some of Obama’s promises:

“And insurance companies will be required to cover, with no extra charge, routine checkups and preventive care…”

On the surface, Obama’s statement makes sense to many Americans. *“Heck, I get a routine physical every year. Why shouldn’t my insurance company be required to pay for it?”* But, remember that insurance “works” when you insure against *unlikely* events. A routine annual physical is not an unlikely event; *by definition it is routine*. It makes absolutely no sense for insurance to cover something that occurs routinely, because the point of insurance is to insure against *unlikely* events.

If you and everyone else who is covered by your health insurance carrier has an annual physical, it is certainly not an unlikely event. The insurance company cannot spread the cost of your exam to other policyholders, because they are also getting routine annual physicals.

Assume your insurance company has 10,000 policyholders, and each one has an annual physical exam costing $500. If will cost the company $5 million per year. Even if there were no claim processing expenses (which there certainly would be) and even if the company added no profit to the transactions (which is must do or go out of business), the company needs to increase its total premiums by $5 million. *It cannot do otherwise*. If it raises premiums less than $5 million it loses money and goes out of business—leaving you with no insurance.

Of course, just processing 10,000 additional claims per year will cost the insurer money, so it will need to hire additional employees to perform the work. Assume it has to spend $100,000 for those additional employees. Assume also that the company is entitled to some profit (even though Obama would rather it earn nothing), perhaps 4 per cent. That $5 million annual expense is now $5,300,000.

To pay for that $5.3 million expense, the insurance company must raise the cost of everyone's annual premium by $530. Thus, on average, each policyholder will pay an additional $530 in premiums to get a $500 annual physical exam. (Of course, not every physician will charge $500; some will charge more, some less.)

There is no way around this. Obama cannot change fundamental laws of economics. If he requires all insurance companies to pay for a procedure that every customer will have every year, their operating costs will increase dramatically—and those costs will have to be passed on to consumers in the form of higher premiums. That is unavoidable.

Obama is therefore telling every American that because of his wisdom and kindness they will now have free annual routine physical exams. He is lying. They cannot be free. They will not be free.

Obama also promises, "*We will place a limit on how much you can be charged for out-of-pocket expenses…"*

Your health insurance policy has an out-of-pocket limit for the same reason your car insurance has a deductible. Requiring the policyholder to pay a portion of the incurred expenses keeps the premium costs down. Everyone understands that if they "raise their deductible" their car insurance costs less. That is because the insurance company saves money by not having to handle small claims that sometimes cost more to process than the amount of the claim itself. (A car owner can replace a broken radio knob on his own for much less than the cost of processing an insurance claim for that small part.) The deductible also encourages the driver to be more careful. Knowing that he has to pay the first $500 of any repairs makes him drive and park more carefully. (He's got some "skin in the game.") Having a deductible saves the insurer from paying for minor claims. It return, the policyholder pays a lower annual premium.

A health insurance policy with a 20 per cent "co-pay" and a $2,500 out-of pocket limit (as an example) serves the same purpose. It keeps premiums lower by shifting some of the costs to the policyholder. If a policy pays for 80 per cent of physician visits, the policyholder must pay the remaining 20 per cent. After that individual has paid $2,500 for the year, the insurer pays all future covered expenses at 100 per cent. The policyholder knows that his expenses will never exceed $2,500.

Because the policyholder has to pay 20 per cent of his health care expenses (up to $2,500), he is more careful about unnecessary visits to the doctor. The co-pay encourages common sense. A high fever rarely requires an expensive trip to the emergency room; it might not even require a doctor visit. Those options are available should the individual believe them necessary, but they need not be the first option.

As with car insurance, the high deductible enables the insurer to lower the annual premium. There is nothing preventing an individual from buying a policy with no deductible, but he must be prepared to pay a higher premium. (He may not have the option, of course, if he is covered by an employer-provided group policy with fewer options.)

Obama now says the federal government should place a limit on all out-of-pocket limits. He did not specify an amount, but assume it will be only $500. For the average American, that may sound wonderful. If your $2,500 limit is reduced to only $500, you would save as much as $2,000 per year. Again, if 10,000 people also have policies with that company, consider the consequences. The insurer now has to cover as much as $2,000 per person that it did not cover previously. That adds up to $20 million. Because the insurance company cannot print money (as the federal government routinely does when it "runs short of cash" every year), it has to raise an additional $20 million in revenue. How does it get that money? It has only one option: it raises premiums. Even if there are no new administrative expenses (which there would be) and even if there is no profit associated with that $20 million, premiums would have to be raised by $2,000 per year. (When *your* premium is raised, don't forget to write a thank you note to Obama and any legislator who supported his proposals.)

Many policyholders are healthy, of course, and might go all year without seeing a doctor or filing any claim forms. If there are many people like that, the insurer's costs will go up much less than $20 million. Assume a lowering of the out-of-pocket from $2,500 to $500 will cause the insurance company's costs to go up only $10 million. In that case, the policyholder premiums will not increase by $2,000, they will increase by only $1,000 per year.

If you are paying attention, you might say, *"Hey, wait a minute! The person who is healthy who never gets anywhere near that $2,500 limit will now have to pay an additional $1,000 in annual premiums! That's not fair! He's being punished for being* *healthy!"* Exactly. To make matters worse, the lowering of the out-of-pocket limit from $2,500 to $500 will encourage many people to seek unnecessary medical care. That is, once you reach the $500 limit, your insurer would pay everything at 100 per cent, and there is no longer *any* incentive to avoid medical expenses. A high fever might prompt an emergency room visit or physician visit that perhaps could have been avoided. *("What the heck, I'm not paying for it, so I'm going to the emergency room!")* A migraine headache might prompt a patient to request an unnecessary brain scan because "someone else is paying for it," when a co-pay might help him realize that he's had them for years, just like his parents, and it's a waste of money for an expensive test just to rule out the remote possibility of a brain tumor.

After the out-of-pocket limit is forced lower by Obama, the net result will be higher insurance premiums for everyone—*including* those Americans who are healthy because they are living and eating responsibly. It will also result in an increase in unnecessary physician and hospital visits, creating a shortage of services for those who actually need that care. (The woman who actually has a brain tumor will have to wait for her brain scan because the diagnostic machines are tied up by overly cautious people with migraines.)

Obama also states that insurance companies *"…will no longer be able to place some arbitrary cap on the amount of coverage you can receive in a given year or a lifetime."* The annual limit imposed by most insurers has, regrettably in some cases, not kept up with rising medical care costs. A policy with a $250,000 annual cap might seem like all the coverage one would ever need, but policy limits are now reached more quickly than in the past. Even a $1 million limit has a potential for being exceeded.

Forcing insurers to eliminate those annual and lifetime limits should be less controversial than the other rules Obama plans to impose. Certainly no one wishes to be in the position of someone whose $1 million limit has been exceeded by $500,000. Few Americans can write a check for the difference. Nevertheless, to pay for the elimination of those limits, insurance premiums must be raised. If the insurer has 10,000 policyholders and removing that limit costs the company $5 million per year, that $5 million expense will mean an annual premium increase of $500. The insurance company cannot print money.

Obama states, *"Under this plan, it will be against the law for insurance companies to deny you coverage because of a pre-existing condition."* Some Americans hear that and say, *"That makes sense."* Others hear it and reasonably ask, *"Why then should I even bother buying health insurance?"* If no insurance company can turn you down—if it *must* issue you a policy *regardless* of what injury you may have or what injury you may have incurred—why would anyone in their right mind purchase health insurance *before* they get sick or are injured?

Millions of young, healthy people who are without health insurance choose not to buy it because, well, they are young and healthy. They assume the odds are with them, and they are correct. Some of them are more cautious, of course, and they buy insurance "just in case" the worst should happen. After all, even a young person can get cancer. Their insurance is not for a runny nose or a strep throat infection; it is for the unlikely event of something tragic, like cancer.

Obama now comes along and says, *"Under this plan, it will be against the law for insurance companies to deny you coverage because of a pre-existing condition."* Any young person with a brain who has insurance "just in case" he develops cancer will react to Obama's new law by canceling his health insurance policy! After all, *the policy no longer serves any purpose!* The young person can skip the insurance, save the money he would have spent on premiums, and pay for his runny nose or strep throat treatment entirely out of his own pocket. If he should happen to get cancer next year or the year after, he can apply for health insurance at that time. After all, Obama promised that he *cannot* be denied coverage! If the young person (or an older person, for that matter) breaks his neck in a motorcycle accident, he can apply for a policy at that time—because Obama says he *cannot* be denied coverage. After his treatment ends, he cancels the policy. If he ever needs treatment again, he simply purchases another policy!

Some would argue, *"That's crazy, that's not what Obama meant!"* What then did he mean by *"Under this plan, it will be against the law for insurance companies to deny you coverage because of a pre-existing condition"*? If you learn you have cancer and *then* apply for a policy, can you be turned down? If the answer is yes, what did Obama mean? Would not that policy applicant's cancer be a pre-existing condition? If you break your leg in a skiing accident, will you be denied a policy or turned away at the hospital? If so, how does "Obamacare" improve things for you?

Obama and his fellow "progressive" Democrats may be socialists but they're not entirely stupid, so they allow for the inevitability of people taking advantage of his pre-existing mandate by *forcing* all Americans to buy health insurance policy and imposing a *fine* if they do not. You probably did not catch that in Obama's speech—because he intentionally left it out. He said, *"…under my plan, individuals will be required to carry basic health insurance…"* but he neglected to describe how he would enforce such a requirement. (Any mandatory insurance requirement would clearly be unconstitutional, which might prompt some to wonder how Obama could have properly taught Constitutional law.)

How will this mandatory insurance requirement work? In all likelihood, all Americans will have to provide proof of health insurance from a "qualified" plan when they file their 1040 tax forms each year. If you have no such coverage, you will pay a fine. Your income tax refund (if you happen to be entitled to one) will be reduced by the amount of the fine. If you owe income tax, you will have to add the fine to what you owe. (The term "fine" will be used because Obama promised he wouldn't raise your "taxes.")

How much will the fine be? That remains to be seen, but a $3,800 fine for a family of four has been discussed by (Democrat) legislators. The fine/tax for an individual may be in the $750-$1,000 range. (One can imagine how many young Americans who voted for Obama will react when they learn that the "free" health care they all thought they were going to get will not be free. The new fine may not be the "change" they "hoped" for.)

If the annual cost of health insurance exceeds the $3,800 fine (as it most assuredly would), some families will respond by reluctantly paying the fine and going without health insurance. When they get sick, they will go to the emergency room of the local hospital. They will still have health care, but it will cost them only $3,800 per year—while everyone else will see their premiums increase.

It should be obvious to everyone that an energetic, healthy person in his 20s is less motivated to buy health insurance than a lethargic, overweight person in his 50s. An insurance company writing a policy will obviously need to charge a higher premium for the latter than for the former. By forcing insurance companies to accept *all* customers regardless of their age or condition (including morbidly obese smokers, those with a high risk for HIV/AIDS, drug users, etc.) Obama is forcing them to take on billions of dollars in new liabilities. Because those companies cannot print money, they will necessarily have to raise premiums across the board to cover those added costs. Those responsible Americans who take care of themselves will be forced to pay even more to cover the expenses of those who do not, and those who should be doing more to improve their health will have one less reason to act responsibly. (How does promising health care "no matter what" discourage young people from taking up smoking?)

By now, you have likely figured out that nothing advertised as "free" is really free. Obama's plans will mean higher health insurance premiums—*skyrocketing* premiums, in fact. That, of course, will give Obama a chance to pile more blame on the insurance companies, and get Americans angry and frightened enough that they will not care when he takes over the industry completely and institutes national health care—run entirely by his federal bureaucrats.

What are the alternatives to "Obamacare?"

First, when Obama said, *"Unfortunately, in 34 states, 75 per cent of the insurance market is controlled by five or fewer companies… Without competition, the price of insurance goes up and the quality goes down,"* he knew that few Americans understand it is the *government that caused that problem*—by prohibiting insurers from selling policies in other states. A company in State X is not permitted to sell insurance to residents of State Y. The companies in State X therefore have a government-supported monopoly. Further, state governments impose requirements on insurance carriers that apply only in their state. If the legislators in State X force insurance companies to cover acupuncture, for example, those companies must necessarily raise their premiums to cover the cost of those added acupuncture expenses. Because of economies of scale, those requirements and regulations make it more difficult for the smaller insurance companies to stay in business. Those smaller companies fail, and their customers have fewer insurers from which they can choose a replacement policy. The remaining companies grow even larger and have greater influence in the state legislatures, and the situation worsens.

Obama tried to further support his case by stating "In Alabama, almost 90 per cent is controlled by just one company." Unless one thinks that 90 is the same as 75, Obama was lying. Blue Cross Blue Shield of Alabama has 75 per cent of the state's insurance market, not 90. It does not "control" that market, it gained those customers by providing insurance with lower than typical premiums and administrative costs. (Note the use of the word "controlled" by Obama, an intentional effort to portray as evil a company that provides a service millions of Americans value.) If Blue Cross Blue Shield has few competitors in Alabama it is only because the government prohibits its customers from buying insurance from a company in one of the other 49 states.

If State A places fewer restrictions and requirements on insurance carriers within the state, prices are lower in State A. Residents of State B may be paying for acupuncture, aromatherapy, abortions, message therapy, in vitro fertilization, or any number of treatments and procedures for which they have no use or need. But because they live in State B, they are stuck. They have no lower-priced options because the government makes it illegal for them to buy insurance from a company in State A.

If Americans were permitted to buy insurance from out-of-state carriers, the cost of health care would immediately go down as millions of policyholders switched to lower-priced policies. Billions would be saved each year. There is absolutely no justification for prohibiting interstate competition.

Second, insurers should be allowed to provide "bare bones" policies that cover only catastrophic, unlikely events. Let the companies issue policies that do *not* cover treatments like acupuncture and aromatherapy. Prices will fall for those who buy the no-frills policies, and they will go up for those who want cradle-to-grave coverage for everything. That is how it should work—just as the owner of a new Corvette *should* pay more to insure his vehicle than the owner of an old sedan.

Third, Americans must recognize that insurance is meant for exceptional events. It was never intended to cover everything. No one should expect to go through life never having to pay any of his own money for health care, just as no one should expect to go through life with all his groceries paid for by someone else.

Fourth, pass tort reform legislation that reduces some of the outrageous awards given in lawsuits. When a lawyer persuades a sympathetic and uninformed jury to award tens of millions of dollars in a malpractice case by lying about the cause of a patient's condition, everyone pays. When a doctor prescribes a test not because the patient needs the test but because he is afraid of being sued if he does not, everyone pays. When a physician pays $80,000 or more per year in malpractice insurance premiums and has to pass those costs on in increased fees, everyone pays. Frivolous lawsuits must be stopped with "loser pays" penalties and other methods. (Obstetricians in some states pay as much as $200,000 *per year* in malpractice insurance premiums, and that $200,000 is necessarily paid for by passing it on to patients and their insurance. The "all my problems are somebody else's fault" attitude in the United States is costing everyone a fortune in higher prices. When a baby is born with a disability, the parents frequently sue the doctor who delivered the child—even when there is no evidence suggesting he did anything wrong.)

Fifth, tell your legislators—at both the local and national level—that you have had enough of the "nanny state." Demand that they get rid of rules and regulations, not add more. Government *caused* the problems, and government can solve them only by getting out of the way.

Lastly—and most importantly—don't believe everything a slick politician tells you. When he says you'll get something for nothing, decide right then and there to work for his defeat in the next election. A lie told to a joint session of Congress is still a lie—even if no one in the audience yells out the truth.

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