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The 'Public Plan' Would Be the Only Plan

It's impossible for private insurers to 'compete' with government.

By SCOTT E. HARRINGTON

The Obama administration and the Democratic congressional leadership appear poised to create a "competing" government health insurer as part of its health-care reform. President Obama believes this would provide "a better range of choices, make the health care market more competitive, and keep the insurance companies honest," as he wrote to Sens. Edward Kennedy and Max Baucus on June 2.

In reality, equal competition between a public plan and private plans would be impossible. The public plan would inexorably crowd out private plans, leading to a single-payer system.

Advocates claim that a public plan would achieve significant savings in administrative costs. Among other omissions, they ignore that a significant proportion of private insurers' expenses are incurred for creating and maintaining provider networks, and for monitoring payments to reduce waste and fraud. Private health plans have a strong incentive to spend a dollar as long as the expected savings in payments is at least a dollar. The resulting expenditures increase reported administrative costs, but they save money overall. A public plan will not have comparable incentives.

The argument that a public plan would not need profits and would prevent excessive private-plan profits is populist rhetoric. Profits are needed to earn normal returns on the capital that private insurers invest to back the sale of coverage and to make promises to pay claims secure. They have not been excessive compared with other industries. A public insurer wouldn't have to hold amounts of capital comparable to private plans. It would be backed by taxpayers. Nor would it likely be subject to the same taxes that private insurers pay, including those on investment returns from holding capital. "Competition" on this level just isn't possible.

Equal public-private competition in reimbursing hospitals and physicians is likewise a nonstarter. One proposal is for a public plan to pay Medicare rates, perhaps with a small markup. Because Medicare reimbursements already entail substantial cost-shifting to private payers, any expansion of Medicare payment rates, with or without a modest markup, would further shift costs to private payers and accelerate the crowd-out of private plans.

The alternative of having private plans reimburse providers at public-plan rates would require significantly higher reimbursements than under Medicare to avoid bankrupting many hospitals and physicians. This "single-payer light" approach would produce universal price controls on medical services and raise the obvious question: Why bother with private plans?

Having the public plan instead pay private-plan rates would violate a major objective of many advocates: cutting costs by reducing reimbursements. Even if politically feasible, this approach would need to address complex design and administrative challenges to benchmark rates negotiated between thousands of providers and numerous private health plans.

With or without a public-plan option, reform legislation is almost certain to substantially narrow the dimensions on which health plans compete. Given the fixation of many reform proponents' on attempting to ensure that no person's premiums or coverage terms will be related to health status, private plans will be required to accept all applicants, probably at rates that vary only with age and geographic region. There will be heavy constraints on benefit design and marketing, perhaps with ex post transfers of funds among insurers to even out profitability. Under the guise of preventing "cherry picking" health customers, a government-run plan could easily be accompanied by additional constraints or surcharges on private plans to deter them from offering attractive options.

The simple truth is that equal competition between a government health-insurance plan and private plans would be impossible. An ostensibly competing public plan would make a single-payer system inevitable. Health-care providers and other Americans should recognize this reality and be prepared for the consequences.

Mr. Harrington is professor of health-care management and insurance and risk management at the Wharton School of the University of Pennsylvania.

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