Creating a Moral Hazard With Health Care Reform

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Article Word Count: 525 [View Summary] Comments (0)

The health care reform debate has come and gone, at least the part leading up to the passage of the Patient Protection and Affordable Care Act. Plenty of debate and legal challenges will continue into the foreseeable future. Some of that debate will center around the moral hazard created by the new law, something that should have been obvious to the legislators behind it.

The term "moral hazard" should be familiar to anyone who has studied economics. It is covered in many university courses to some extent when studying financial instruments such as insurance. One of the simplest examples of creating a moral hazard is fire insurance. A fire insurance policy that would pay more than the value of a structure under any circumstances would create an incentive to burn the structure for profit, hence creating a moral hazard. Another example would be a very large life insurance policy that would pay more than the value of a structure under any circumstances would create an incentive to burn the structure for profit, hence creating a moral hazard.

It would appear that the moral hazard introduced by the new health care reform law weren't considered or addressed in advance. For one, the requirement that all Americans purchase health insurance or face a fine creates a moral hazard for anyone who examines the relative costs. Published studies show that in 2009 the average cost of health insurance was approximately $4,800. In other words the "average" person would be paying around $400 per month in health insurance premiums. Under the new law the penalty for not purchasing health insurance can be as high as $695, substantially lower than the cost of buying insurance. But the cost difference between buying insurance versus simply paying the penalty isn't
the key enabler of the moral hazard. The key is that the new law forbids insurers from denying benefits to people with pre-existing conditions. So there is no risk that a person would be unable to obtain insurance if they became sick or injured. Taken together with the lower cost of going uninsured there is a huge loophole that creates a moral hazard that will certainly be exploited by many people.

The strategy is simple. Don't buy health insurance. Pay the penalty each year and pocket nearly $4,000 in savings. If you become sick or injured then buy insurance to cover treatment costs - you can't be denied. With this strategy you can purchase the most expensive and highest coverage insurance to pay for nearly all your medical expenses at the time you need it. It remains to be seen if this moral hazard is mitigated before the new law goes fully into force. Without some mitigation measures one would expect insurance premiums to increase as people choose penalty over coverage and fewer people are buying insurance. That will force more people to exploit the situation again raising premiums, with the whole system spiraling out of control.

Mark George is an American expat living in Thailand and observing the U.S. health care reform debate while enjoying local world class health care at a fraction of U.S. prices. For first hand experiences of medical tourism in Thailand read his Medical Travel blog.

Article Source: http://EzineArticles.com/?expert=Mark_George
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Article Submitted On: May 21, 2010

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