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ON OUR MINDS

The Big Dance

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With all due respect to the college basketball tournament now nearing its conclusion, I think its affectionate monikers "The Big Dance" and "March Madness" might be better applied to the equally compelling spectacles that have been playing out this month in our nation's capital. In Washington as in NCAA hoops, many teams are competing across multiple venues, but always with the goal of advancing their own positions – a zero-sum winner-take-all mindset.

Most of the nation's political attention last week was focused on the multifaceted choreography on display on the Capitol's dance floor, as Republicans tried to repeal parts of the Affordable Care Act. The astute political observer Tom Lehrer described precisely the kind of dance performed by President Trump and Speaker Ryan, along with their Terpsichorean troupes:

> *Let our love be a flame, not an ember,*
> *Say it's me that you want to dismember.*
> *Blacken my eye, set fire to my tie,*
> *As we dance to the Masochism Tango.*[1]

There were no real winners in the health care version of March Madness.[2] Instead, there were plenty of blackened eyes and burned ties (metaphorically speaking) in this tango. Certainly the President and the Speaker have seen their influence diminished; likewise, Republican Senators and Representatives should be embarrassed that they failed to close ranks around what nearly all of them had identified as their top legislative priority; and even the Democratic members can't gloat when the action is about to shift to regulatory venues where their unified stance will be irrelevant. Sadly, the biggest loser may yet be the American public, which is still stuck with a badly broken health care delivery and payments system.

Obamacare tried to fix one aspect of the system, increasing access to care by creating subsidies and penalties to compel people to sign up, and it simultaneously established minimum standards of policy coverage. Trumpcare would have replaced subsidies and penalties with tax credits (which wouldn't have helped people whose incomes are so low that they don't pay taxes in the first place). Both the ACA and the stillborn American Health Care Act impelled sharply higher premiums and lower benefits for many Americans.

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[1] Yes, I know Tom Lehrer was describing an entirely different type of relationship, but give him a break: He composed these lines a half-century ago.

[2] One could argue that the 24 million people whose access to coverage has been protected for the moment could be considered winners; perhaps it might be better to use the term "non-losers," inasmuch as their coverage will still be potentially at risk when the state governments and federal regulatory bodies take to the dance floor.

The Republican effort to rewrite the ACA was doomed to failure for the same reason that Obamacare itself could never live up to its sponsors' aspirations: Congress was attacking the wrong problem. Both Obamacare and Trumpcare implicitly assume that the costs embedded in the health care system are fixed, and that the political imperative is to rearrange who bears those costs by altering the mechanisms by which providers are paid. That's a myopic view.

The real problem isn't redistribution of costs, it's that the overall cost of health care to society is simply too high. The price-setting *purchasers* of health care (insurers and governments) are not the *consumers* of health care (you and me). When we have no idea what the true cost of health care services are, how can we decide wisely whether and how to purchase them? Without price discipline, we clamor for more service, and the health care providers have every incentive to indulge us. The result is that prices are distorted compared with costs.[3] It seems ironic that this complex system arose in part to create a social good (universal access), yet now the complexity and distortions perversely still preclude access but for government intervention.

Rather than "bash in my brain and make me scream with pain" (*pace* Mr. Lehrer) by trying to shuffle existing costs among providers and intermediaries and consumers, perhaps the better approach might be to find ways to reduce the overall costs of health care in this country. I don't pretend to be an expert on health care economics, but many members of Congress are. Among options they could consider might be market-driven mechanisms, price regulation, or single-payer models.[4] All of these options can be modified to ensure universal access to care.

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As investment managers, my team and I are instinctively attuned to a single question: How will markets react? We're not surprised that markets are taking Friday's drama in stride. While the Trump team had made health care its first priority, investors had long ago concluded that it would be one of the most difficult challenges the new administration would undertake. Trying to force-fit a repeal of the ACA into a filibuster-proof reconciliation bill required too many unpalatable choices, as Speaker Ryan and President Trump discovered to their chagrin.

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[3] The same problem is evident in higher education, and for the same reason: College purchasers (mainly the federal government in the form of its student loan programs) and college consumers (students) are disassociated, which lets colleges raise prices at will to support programs at levels that might not survive in a more transparent system. Student loans, like health care contracts among insurers and providers, serve to disguise the underlying cost of the service such that consumers want ever more access to college, and don't know or don't care about the true cost.

[4] The Republicans who sank Trumpcare will argue that marketplace mechanisms will work if they are unfettered by regulatory burdens; yet opponents believe that marketplace mechanisms will leave too many people with no access if no providers can operate profitably in certain market segments.

Alternatively, price-based regulation could be imposed either on the direct provision of service or on insurance companies who would then pass the belt-tightening indirectly to service providers. That model worked well in telecom in the 1990s, a similarly complex industry with embedded subsidies that distorted all sorts of behaviors. Yet this model may not be politically viable if prices are set too high (foreclosing access for large numbers of people) or too low (causing providers to abandon the market).

The single-payer model still has its adherents, of course, and the prime evidence in its favor is that Medicare has been successful for over 50 years. On the other hand, its costs continue to rise because of demographics, and other single-payer markets (like the Veterans Administration) have been huge failures.

The more interesting question in our recent morning meetings has been how the expected failure of Trumpcare might affect other Republican legislative priorities. The New York Times had all sorts of dire outcomes plastered over its pages yesterday: "Trump Becomes Ensnared in Fiery GOP Civil War;" "Ryan Emerges From Health Care Defeat Badly Damaged;" "GOP Members Who Backed Bill Are Left in the Lurch;" and more. To read the Times' package of articles is to conclude that the rest of President Trump's campaign agenda – infrastructure investment, tax reform, trade policy, and so on – is now in shambles.

Yet some of the President's ideas still have widespread support on Capitol Hill and among voters, and likely could be enacted fairly easily. The Democrats have already proposed a trillion-dollar infrastructure bill, and both parties have expressed interest in tax reform. These programs can be done, and with health care off the agenda it's even possible that their timetable might be accelerated to be completed in the next several months.

The only way to enact any of this agenda, however, is with bipartisan effort; a "reconciliation" process is no longer viable. Obamacare was a rare anomaly in winning passage without a shred of bipartisan cooperation. History shows that big legislative ideas only succeed when they have engagement and ownership on both sides of the aisle; the Gramm-Bradley tax reform of 1986, for example, would have died without its namesake Senators of opposite parties (and President Reagan and Speaker Tip O'Neill) working together to bridge differences and weed out overly partisan elements. Even Great Society programs like Medicare had Republican support.

In the current environment, a bipartisan tax package would likely encompass corporate and individual tax cuts, repatriation of corporate earnings held abroad, and limited deductibility of interest expense. It wouldn't be as ambitious or as pro-growth as many Republicans want, but it would have the enormous virtue of being able to reach President Trump's desk.

Investors remain lukewarm on tax reform and infrastructure legislation. As I've written in previous *On Our Minds* commentaries, I don't think stock prices or bond yields ever fully anticipated enactment of the President's agenda; although last week's slight dip in stock prices and bond yields undoubtedly was in part due to unfolding events, the reaction was quite muted.

Despite increased attention to domestic politics, fundamentals remain paramount: Stock prices have been held aloft mostly by rising corporate profits growth, and bond yields have been held down mostly by pressure from foreign central banks. If Congress and the President can rise above their petulance and bickering, they might realize that sharing a Strauss waltz is infinitely more satisfying to themselves and to investors than another round of the Masochism Tango.