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Government-Centered Health Care Overhaul Bound to Fail

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Why is Washington having so much trouble reforming health care? And why, if Congress passes a major overhaul, are the problems of cost, quality, and access almost certain to get worse?

Answer: Because Washington doesn't understand health care. Almost no one in Congress understands health care as a complex system.

When they campaign, most politicians claim health care problems could be solved with a few simple reforms. Now that it's time to legislate, they are discovering the issue is exceptionally complicated. In fact, there is no solution that even comes close to being simple or easy.

Economic Ramifications

That's because the economy is a highly complex system. Yet instead of being careful about tampering with it, state and national policymakers have completely suppressed normal economic forces in virtually every aspect of health care. What we are left with is almost certainly the most complicated market of all, with no reliable model with which to understand it.

In complex systems, a change of parameter in one place inevitably causes other—often

surprising and unforeseen—changes elsewhere.

Perturbations intended to bring about one result inevitably have other, unintended consequences. In health care, the unforeseen surprises are even more palpable because reforms are inevitably designed by people who either deny the existence of economic incentives or routinely ignore them.

I suspect most members of Congress were genuinely surprised to learn that:

- * If a children's health program is offered for free, half the enrollees will be from families that drop their private insurance to get it.

- * A highly subsidized "exchange" outside the workplace would cause millions to drop their employer-provided coverage.

- * Given the chance, millions of people would leave Medicaid for highly subsidized private insurance.

- * Spending \$1 trillion over 10 years would ultimately reduce the number of uninsured by only 20 percent.

Perverse Incentives

One thing economists are confident about is this: No matter how complex the system, the incentives faced by the individual actors matter a great deal. And if all the actors in a complex system have perverse incentives, the social outcome is likely to be undesirable.

In health care, almost everyone faces perverse incentives. When people act in their own interests, they usually impose external (social) costs on others. This means the social cost is likely to exceed the social benefit for every actor at every margin.

Total spending on health care is the outcome of about 300 million patients and about 800,000 doctors all interacting in complex ways. But it is also the simple, straightforward sum of what I and my doctors spend on my care plus what you and your doctors spend on your care over 300 million people. No matter what else happens, if my doctors and I don't change what we are doing for me, and you and your doctors don't change what's being done for you—and so forth—aggregate spending will not change.

No Idle Resources

If I am a representative patient, every time I spend a dollar, only 13 cents will come out of my own pocket. That means my incentive is to consume care until it is worth only 13 cents on the dollar to me. This is very wasteful, but I'm wasting your money (you being the other members of my insurance pool), not mine.

Under current reform plans, third-party coverage would become much more expansive, and we would have to pay only

four or five cents out of pocket for every dollar we spend. Because this is a complex system, it is very hard to predict how all this new spending will affect the system as a whole. But we can be fairly confident total spending will rise—and probably by a lot.

Now consider the problem of access. Millions of uninsured people will obtain insurance, and millions of people who are currently insured will get more generous insurance. These people will use their newfound coverage to try to obtain more care. But where will they get it?

As you look around the health care system, how many idle resources do you see? How many primary care physicians have empty waiting rooms? How many ERs have no patients waiting to be seen? And if there are no significant idle resources, how will the increased demand for care be met?

Clearly, there will be a rationing problem, and those paying below-market rates (Medicaid patients, etc.) will experience more severe problems than others. This is precisely what is happening in Massachusetts right now—waiting times to see doctors in Boston are more than twice as long as in any other U.S. city.

Improving Incentives

For more than two decades, numerous scholars have outlined ways to reform the health care system by improving the incentives faced by the actors in it.

Congress is choosing a different course. Under the reforms being considered, almost everyone's incentives will become worse, not better.

The tragedy is that Congress is almost completely unaware of the harm it is about to unleash. (At least that's the charitable assumption.) The irony is that this same

tragedy has been repeated in almost every other developed country in the world, so we should know better.