Chapter II

PRINCIPLES OF REFORM

What are the principles of health reform? One might suppose they are fairly easy to enumerate and command widespread support. As it turns out, that is not the case. Here are five recommended principles. If they are followed, the odds of successful health policy reform will be greatly enhanced.

Principle No. 1: No One Should Be Denied Basic Care because of a Lack of Ability to Pay.

A good society does not withhold basic health care from people because they lack the resources to pay for it at the time of delivery. This does not imply that people have a "right" to free care. If that were the case, everyone would have a perverse incentive to become "free riders," wastefully over-

consuming care at everyone else's expense. Instead, most people should be expected to pay their own way most of the time. But no one should have to forgo basic care because they can't pay for it at the time of delivery.

Principle No. 2: Health Care Should Be Provided in a Competitive Marketplace.

The economic definition of efficiency is: Whatever is produced should be produced at minimum cost. Some studies lend credence to the idea that one out of every three dollars of health care spending is wasted.[1] This implies that, in principle, the same health care could be provided for two-thirds the cost. Alternatively, there could be 50 percent more care for the same amount of money. In other markets, entrepreneurs spur efficient production by repackaging, repricing and taking advantage of new products and innovations. Principle No. 2 is not being followed whenever entrepreneurs are arbitrarily prevented from serving this function.

Principle No. 3: The Appropriate Level of Insurance Depends on the Assets to Be Protected.

If Principle No. 1 is followed, people will not need insurance to receive care. Instead, they will need insurance in order to protect their earning power and other assets from unexpected health care costs. Other forms of insurance serve as a useful guide. The purpose of life insurance is primarily to protect earning capacity against the consequences of premature death. Accordingly, the appropriate level of insurance depends on current assets and expected income. The purpose of casualty insurance is to protect the value of, say, a home or automobile. The appropriate level of insurance depends on the anticipated risk and the replacement value of the home or car. Similarly, the purpose of health insurance should be to protect assets against unexpected medical costs.

Principle No. 4: Health Insurance Should Be Personal, Portable and Renewable.

It is a mistake to have a system in which a change of health plans is virtually mandated whenever people change employers. Instead, health insurance should be portable (traveling with the employee from job to job). Also, it defeats the whole purpose of insurance if premiums can rise in response to an adverse health event. Life insurers do not get to charge more to the insured who get AIDs or cancer. Insurance exists to transfer risk from the individual to an (insurance) pool. The price of that transfer is the periodic premium payment. Once the insurance contract is set, the practice of increasing premiums after an adverse event occurs would be like changing the odds on a horse race after the race is underway.[2] Accordingly, people should be able to buy health insurance that is renewable at rates that are independent of adverse health events. In most states, this is required under the laws governing individual insurance. However, such insurance is generally unavailable in the small group market.

Not withstanding all of the above, from time to time people may wish to change their insuranc coverage. At that point they should be able to buy real insurance in a real market. It is to everyone's advantage to be able to face real prices for risk when making changes in insurance coverage. Otherwise, people who are undercharged will overinsure, and people who are overcharged will underinsure.

Principle No. 5: Private Insurance Should Be at Least as Attractive as Health Care Provided at Taxpayer Expense.

For many people, the implicit alternative to private insurance is to rely on charity care paid for by others. For those who qualify, Medicaid and S-CHIP programs are alternatives to private insurance. Perversely, these alternatives encourage people to forgo private coverage paid from their own pockets in order to take advantage of care provided at taxpayer

expense. Rational public policy would create the opposite incentives. At a minimum, government should be neutral — giving people just as much incentive to be in the private sector as in the public sector.

Notes

1 Interestingly, there are three completely different contexts in which this idea arises and they are by no means mutually exclusive. First, the RAND Health Insurance Experiment found that when people are exposed to significant cost-sharing (through copayments and deductibles), they reduce medical expenditure by about 30 percent with few significant health effects. See Joseph Newhouse, *Free for All? Lessons from the RAND Health Insurance Experiment* (Cambridge, Mass.: Harvard University Press, 1993). Second, a different RAND study concluded that about one-third of all medical procedures are unnecessary. See Robert H. Brook, "The RAND/UCLA Appropriateness Method," in K. A. McCormick, S. R. Moore and R. A. Siegel, *Clinical Practice Guidelines Development: Methodology Perspectives* (Rockville, Md.: Government Printing Office, 1994). However, see the NCPA critique of this conclusion in John C. Goodman and Gerald L. Musgrave, *Patient Power: Solving America's Health Care Crisis* (Washington, D.C.: Cato Institute, 1992), pages 517-21; and in John C. Goodman, Gerald L. Musgrave and Devon M. Herrick, *Lives at Risk: Single-Payer National Health Insurance around the World* (Lanham, Md.: Rowman & Littlefield, 2004). Third, a Dartmouth study concluded that Intermountain Health System in Salt Lake City treats patients for about one-third less with better health outcomes. See John E. Wennberg et al., "The Care of Patients with Severe Chronic Illness: an Online Report on the Medicare Program by the Dartmouth Atlas Project," Dartmouth Atlas of Health Care, Center for the Evaluative Clinical Sciences, Dartmouth Medical School, 2006. Available at http://www.dartmouthatlas.org/atlases/2006_Chronic_Care_Atlas.pdf. Accessed February 19, 2007.

2 A useful contrast is with automobile liability insurance, unemployment insurance and workers' compensation insurance. In these cases the insurable event is influenced by the activities of the insured so if experience reveals that an individual or business is at greater risk of generating claims, it is appropriate that higher premiums reflect that risk. Health insurance, by contrast, is designed to insure against contingencies over which the insured has no control. The risk that someone might get cancer, for example, and face continuing medical bills for many years is exactly the kind of risk people should be able to fully insure against.