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The Problem of Unintended Consequences

By: John C. Goodman **July 16, 2012**

Ideal health insurance is often said to be health insurance with no deductible or co-payment, making medical care essentially free at the point of delivery. Yet, if patients have no out-of-pocket costs, their economic incentive will be to overuse the system, essentially consuming healthcare until the last amount obtained has a value that approaches zero. Also, if patients are not paying money for the services they receive, they're not likely to shop around for the best buy, so doctors, hospitals, and other providers will not compete for patients based on price. They will have no economic incentive to keep costs low—the way producers behave in other markets. To the contrary, the incentive of the providers will be to maximize against the payment formulas in order to enhance their incomes.

As I discuss in my latest book, *Priceless: Curing the Healthcare Crisis*, published by the Independent Institute, well-intentioned public policies designed to make healthcare affordable for individuals, therefore, have had the surprising effect of causing healthcare spending to become unaffordable for the nation as a whole. Rising healthcare spending is the principal cause of our out-of-control federal deficit. It is bankrupting cities, counties, and state governments. It has created huge un-funded liabilities for some of our largest corporations. It is contributing to the stagnation in worker take-home pay. It can potentially bankrupt the families of individuals who have the misfortune to become ill—even those with health insurance.

Another well-intentioned public policy initiative—adopted by some states—is to try to make health insurance affordable for people with pre-existing conditions by requiring insurers to charge the same premium to all buyers, regardless of health status. Yet, this legislation has the unintended consequence of encouraging people to remain uninsured until they get sick. As healthy people drop out of the market and only people with health problems remain, the premium needed to cover the insurers' cost begins to soar. In the state of New York, this sort of regulation has produced staggeringly high premiums. For a run-of-the-mill individual policy, United Healthcare Oxford charges a premium of $1,855.97 a month, or more than $22,000 a year. For a family, the premium is $5,707.11 per month, or more than $68,000 a year.[1] A policy designed to make insurance affordable, therefore, is pricing thousands of people out of the market.

Federal health programs provide other examples of unintended consequences of public policies foisted on a complex system. In 1965, Congress passed Medicare in an attempt to increase access to healthcare for the elderly and improve their health status. Members of Congress believed they could do so without any material impact on the rest of the healthcare system. Yet MIT professor

Amy Finkelstein has discovered that the passage of Medicare had no effect on the health of the elderly—at least as measured by mortality—but the additional spending set off a bout of healthcare inflation for all patients—one that never subsided.[2]

In 2003, Congress passed a Medicare drug benefit, largely out of concern that senior citizens couldn't afford the coverage themselves. Since the new program (Medicare Part D) had no funding source, Congress created a $15.6 trillion unfunded liability for the federal government, looking indefinitely into the future—more than the unfunded liability in Social Security.[3] Yet economist Andrew Rettenmaier discovered that only 7 percent of the benefits actually bought new drugs for seniors. The other 93 percent simply transferred to government (and taxpayers) the bill for drugs the elderly or their insurers were already buying.[4] Only one in every thirteen dollars represented a new drug purchase. Interestingly, the help given to the small number of people who were not otherwise getting medications actually reduced Medicare's spending, as drugs were substituted for more expensive doctor and hospital therapies.[5] But this profit on the truly needy was overwhelmed by the cost of giving the benefit to those who didn't need it—a cost that has created an enormous obligation for current and future taxpayers.

Here are two other unintended consequences of health policies designed to make healthcare free at the point of delivery. In other markets, producers don't compete only on price. They compete on quality as well. In healthcare, however, it appears that when providers don't compete on price, they often don't compete on quality either. That may be one reason why critics find that the quality of care we receive (including the very large number of avoidable errors and other adverse medical events) falls far short of what we would expect in a normal market.

Also, in most markets, we pay for goods and services with both time and money, and producers and sellers understand that we value our time as well as our pocket book. Public policies designed to suppress the role of money as a medium of exchange in the medical marketplace, however, have had the inadvertent consequence of increasing the importance of waiting times and other non-price barriers to care. These efforts to increase access to care may well have decreased access instead by making people wait longer to get appointments and to see the doctor once they reach her office.