Harnessing The Forces Of Markets And Innovation

by Ian Duncan

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When I was a boy, not all that long ago, the concept of individual self-service was virtually nonexistent. At the grocery store, you handed a list of items to a clerk behind a counter, who disappeared and returned with your order. In the bank, you queued up—sometimes for a considerable time—in order to cash a check or make a deposit with a teller. A third example is the numerous administrative processes that have been replaced by integrated circuit technology where (as Moore's law states) the capacity of transistors doubles and the price halves approximately every two years. Whole industries have been re-engineered in the last 50 years, transferring activities (shopping, bank transactions, etc.) via technology to customers, increasing choice and efficiency and simultaneously lowering costs.

Contrast these examples with the delivery of health care. Although attempts have been made to drive out costs and involve the consumer more in both the consumption and the purchase of health care, these attempts have generally not been successful in the United States or elsewhere. Why is this? Is it possible to achieve the same gains in productivity in health care? Is there an inherent structural inhibition that prevents us from making the same advances with regard to health care?

Health Care Financing

That we have a problem in health care financing in the United States (and other countries) is clear. One symptom of the problem is health care costs which continue to increase faster than the rate of growth of income. Instead of falling costs and increasing quality—as we see in other industries—we experience rising costs, and most commentators have difficulty making conclusive quality statements.

As actuaries, concerned about both costs and the long term, we should be doing more to explain to the public that the benefits that they have awarded themselves (through Medicare and Medicaid) are unsustainable without significant increases in productivity. Consider the following: the value in current dollars of the Medicare benefit that we provide seniors at age 65 exceeds the accumulated contributions of the individual senior and his employer—assuming a lifetime of contributions at the median wage level—and future retiree contributions by about $250,000. This is, essentially, an unfunded liability to the taxpayer, and an asset to the retiree. The median house price in the United States is currently about $170,000, so we provide retiring seniors an asset worth 50 percent more than a median house. A politician who proposed awarding every senior a free house at retirement would be laughed out of Washington. Yet no one questions whether it is reasonable, sustainable or even a wise use of national resources to provide a free health care benefit worth considerably more. Medicare benefits represent such large unfunded liabilities because of high rates of projected cost increase (trend). If we could reduce future trend to even the average rate of price inflation, the unfunded liabilities would fall to a more sustainable range. The challenge is to find ways to harness the same forces in the health sector that have proven successful in reducing transaction costs in consumer goods, electronics and financial services.

Instead of attempting to harness the forces of the market and innovation that have been so beneficial in other industries, policymakers turn, again and again, to the same failed solutions that have resulted in our present crisis. I am reminded of a comment made by Fidel Castro on the 50th anniversary of the Cuban revolution: the reason for the disastrous state of the Cuban economy is not too much central control, but insufficient socialism! Our Washington policymakers, having failed abysmally to control the cost of Medicare and Medicaid, now propose to extend their reach to the other half of the health care economy that they do not directly control. Like second marriages, truly a triumph of hope over experience!

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Vision For The Future

This paper, however, is about visions for the future of the U.S. health care system. There is an alternative vision that, applied to the U.S. health care system, could unleash the same forces that have delivered increasing quality and lower prices in other industries. Five things are necessary to realize this future:

1. *Change the U.S. tax code*. Currently, the tax code (through the deductibility of health insurance premiums) favors over-consumption of health care at the expense of other goods and services. In a market in which there are obvious diseconomies of scale in health care—with a few notable exceptions—encouraging more health care spending simply raises costs.

2. *Return responsibility for medical decisions to doctors and patients*. Managed care is an important set of tools for educating patients and providers about best practices and cost-effective solutions, but it has become the central cost-control technique in the system. Coupled with a lack of personal budgetary responsibility, managed care is always a villain, rather than an important technique for helping consumers manage their health care dollars. Consumers see no reason for limiting demand or for using managed care techniques, because the third-party payer system makes some other entity responsible for financing care. Individual consumers responsible for managing their own health care budgets will demand that providers provide not just for clinical treatment but also help consumers make the most of the health care dollar.

3. *Encourage individual responsibility.* The case is often made that medical care is too complicated and requires too much specialized knowledge to allow individual involvement. Yet our experience with the Internet is that consumers demand, and use, large quantities of health care information. The great genius of the current U.S. system—and one that we destroy at our peril—is that it decentralizes decision making to many different actors: patients, physicians, managed care companies, employers, etc. Considerable political pressure exists to blow up the existing decentralized system and place decision-making power in the hands of a few technocrats. Yet, as markets have universally illustrated (and a few counter-examples, such as the Soviet Union and the current Medicare system illustrate all too well), centralized decision making can never ensure as efficient, innovative or cost-effective a solution as a decentralized system.

4. *Educate the public about their responsibility for long-term funding*. Ultimately, the success of the U.S. health care system will require individual responsibility for lifetime needs, with perhaps employer subsidies for working employees and some degree of state subsidy for the indigent. The scale of unfunded Medicare (and Medicaid) liabilities, discussed above, is simply too large for the government to continue to provide on a non-means tested basis for the elderly, let alone those who are actively working. The sooner the United States recognizes this and begins to plan for the replacement of universal government-provided care, the sooner we can implement a replacement system. In the meantime, today's young workers should begin accumulating a tax-free fund to take care of their retirement needs. There is no reason why such an accumulation system should not be successful—the IRA and 401(k) models are examples. Depending on the institution with which the worker accumulates funds, the worker would also have access to important components of an insurance package: network discounts, information about provider quality and efficiency and care protocols.

5. *Encourage the type of innovation and disruptive productivity increases that we have seen in other industries.* One of the biggest inhibitors of productivity increases in medicine is the current "expert model," which the medical profession has encouraged and from which it benefits. In the early days of computers computing was a similar "expert model." To access the computer,

you had to approach the computer's acolytes, who wore white coats and inhabited air-conditioned computer centers. Bill Gates and Microsoft came along and disrupted the entire model, placing enormous computing power in the hands of the end user. If we want to control health care costs in the future, we will have to encourage the equivalent of Bill Gates's disruptive technology that places ultimate responsibility in the hands of the consumer. This can be done, and we see a few tiny signs of the coming revolution, as employers begin to provide financial incentives/disincentives to employees to assume precisely this type of responsibility. But for the most part, the medical industry—which is a huge user of medical technology—has failed to embrace consumer-centric technology. Some early solutions exist (for example, home monitoring and test kits for individuals to monitor their own health). The financial incentives—to both members and providers—are not yet in place to support this model, but will develop rapidly as the funding crisis grows.

This vision is clearly radical. However, the president is proposing an even more radical remaking of the system, with vast expenditures and huge concentration of power and decision making in the hands of a few technocrats who have failed to demonstrate that they can manage the 50 percent of the health care economy that they currently direct. An alternative vision—one in which individuals and their providers make the decisions—is possible. It is not too late to reject centralization of the system in favor of the consumer.

This essay was written in fond memory of Jerry Grossman M.D., Kennedy School of Government at Harvard University. A great entrepreneur and true friend, from whom I learned the power of disruptive innovation.

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