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HEALTHY, WEALTHY, AND WISE: FIVE STEPS TO A BETTER HEALTH CARE SYSTEM

By John F. Cogan, R. Glenn Hubbard, and Daniel P. Kessler

After a century of innovations in medical procedures, technologies, and pharmaceuticals, the American health care system produces exceptionally fine results in diagnosis, treatment, and cure. Yet it also has several well-known problems: costs continue to rise inexorably, burdening even the largest corporations; millions of people lack insurance coverage; and there are glaring gaps in the quality and efficiency of care. These problems have significant consequences for both our health care and our economic well-being.

The best prescription for our ailing health system is the subject of intense debate among scholars, advocates, and policymakers. Would additional government spending and regulation solve these problems or can private markets work in health care?

In *Healthy, Wealthy, and Wise: Five Steps to a Better Health Care System* (AEI Press, November 2005), AEI scholar R. Glenn Hubbard, a former chairman of President George W. Bush's Council of Economic Advisers who is also dean of Columbia Business School, has collaborated with John F. Cogan, a senior fellow at Stanford University's Hoover Institution, and Daniel P. Kessler, a professor at Stanford's Graduate School of Business and a senior fellow at the Hoover Institution, to offer a clear plan to make our health care markets work more efficiently and more equitably. Aiming to preserve the strengths of our current health care system while addressing its weaknesses, the authors propose a set of policies that would save Americans about \$60 billion a year and provide insurance to as many as 20 million people who are currently uninsured. These policies would cost the federal government only \$9 billion per year.

Cogan, Hubbard, and Kessler argue that a handful of public policies are largely responsible for most of our current health care woes. They note that in two areas particularly—tax policy and health insurance regulation—misguided policies have seriously hobbled private markets for health services. To increase incentives for consumers to make good choices and provide accountability and competition, they propose a comprehensive set of health policy reforms: tax reform, insurance reform, malpractice reform, providing better information to doctors and patients, and enhancing competition among providers and insurers.

The authors stress that tax reform is a critical first step and propose that out-of-pocket health care spending be fully tax-deductible. Current tax policy has created a strong financial incentive for individuals to purchase health services through employer-provided insurance that offers low deductibles and low copayments. Because of this, an increasing share of our health care spending—especially for routine medical services—is paid through insurers. As a result, patients are unaware of the full cost of care, and their physicians have incentives to use many services that do little to improve patients' health. As Milton Friedman put it, "Nobody spends somebody else's money as wisely as he spends his own." By contrast, out-of-pocket spending is less appealing, as it is paid from after-tax income and receives no tax breaks under the current system.

The authors suggest putting individuals who pay for medical care directly in the same position as those who use insurance by allowing full deductibility of out-of-pocket medical expenditures. They argue that full deductibility will encourage consumers to become more cost-conscious and reduce minimally productive health spending. This reduction in spending, in turn, will lead to lower premiums for insurance, making it possible for more people to buy coverage. Full deductibility will also have other benefits: It will gradually but fundamentally give individuals more control over, and choices for, their health care; it will promote tax simplicity; and it will increase fairness as low-income earners receive more tax breaks.

As an important second step, Cogan, Hubbard, and Kessler propose to reform health insurance regulation. Like the tax preference, inefficient insurance regulation drives up costs and increases the number of people without insurance. The authors propose that insurance companies that meet certain federal standards be permitted to offer plans on a nationwide basis, free from costly state mandates. With this change, insurance would become available to individuals and small groups on the same terms and conditions as those currently available to employees of many large corporations who, because of a quirk in federal law, have been exempt from state insurance regulations for more than thirty years.

The authors also demonstrate that in three other areas—providing information to providers and consumers; controlling anticompetitive behavior by doctors, hospitals, and insurers; and reforming the malpractice system to reduce wasteful treatment and medical errors—research has indicated significant opportunities to improve medical productivity that exceed the cost of the reforms.

John F. Cogan, R. Glenn Hubbard, and Daniel P. Kessler demonstrate in *Healthy, Wealthy, and Wise* that the power of markets can deliver higher-value health care to all Americans and focus insurance and care arrangements on individual needs. The factual evidence they present must be considered by every policymaker and researcher seriously interested in health reform.

JOHN F. COGAN is the Leonard and Shirley Ely Senior Fellow at the Hoover Institution and a former deputy director of the Office of Management and Budget. **R. GLENN HUBBARD** is the dean of the Graduate School of Business at Columbia University, a former chairman of the President's Council of Economic Advisers, and a visiting scholar at the American Enterprise Institute. **DANIEL P. KESSLER** is a senior fellow at the Hoover Institution and a professor of economics, law, and policy at the Graduate School of Business at Stanford University.

HEALTHY, WEALTHY, AND WISE *Five Steps to a Better Health Care System*

by John F. Cogan, R. Glenn Hubbard,
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THE EFFECTS OF THE FIVE POLICY REFORMS

1. Health-Care Tax Reform

- Total deductibility of health-care expenses
- Expanded health savings accounts
- Tax credits for low-income individuals and families

Impact: Lower the cost of insurance; level the playing field between employer-provided and individual insurance; promote catastrophic coverage by leveling the playing field between out-of-pocket expenses and insurance costs.

2. Insurance Reform

- Nationwide portable health insurance
- Subsidized private insurance for the chronically ill

Impact: Reduce insurance costs and promote insurance coverage and portability.

3. Improve Health Information

- Expand number and scope of report cards on doctors and hospitals
- Promote use of “best practices” through guidelines

Impact: Make better shoppers and improve the performance of doctors and hospitals.

4. Control Anticompetitive Behavior by Providers and Insurers

5. Reform the Malpractice System and Study the Tax Preference for Nonprofits

Impact: Lower costs of care; increase insurance coverage; reduce medical errors.

Net Impact:

- 6–20 million more insured Americans
- 9 percent reduction in health-care expenditures