

Introduction

Health care in the United States has made remarkable advances over the past forty years. Dramatic improvements in medical technology have expanded both the length and quality of life. In general, Americans are remarkably satisfied with the quality of their health care. Yet our health-care system also has several well-known problems: high costs, significant rates of uninsurance, and glaring gaps in quality and efficiency.

How can we preserve the strengths of this system while addressing its weaknesses? Policymakers, like Americans as a whole, are divided about whether we should make private markets work better or increase the government's involvement in health care. Supporters of private markets point out that competition and choice provide consumer satisfaction in most markets; health care should be no different. Supporters of public intervention argue that high costs and imperfect information give government a direct role in health care.

2 HEALTHY, WEALTHY, AND WISE

In our view, the unintended consequences of a handful of public policies are in large part responsible for the problems of the health-care system. These policies share a common feature: They fail to promote the proper functioning of markets. In two areas, tax policy and health-insurance regulation, government policy has actively hindered the operation of markets for health services.

Current tax policy generally allows people to deduct employer-provided health-insurance expenditures, but requires direct out-of-pocket medical spending to come from after-tax income. This tax preference has given consumers the incentive to purchase health care through low-deductible, low-copayment insurance instead of paying for it out-of-pocket. This type of insurance has led to today's U.S. health-care market, in which cost unconsciousness and wasteful medical practices are the norm. State health-insurance regulation, by requiring insurers to cover certain types of care and restricting their ability to set premiums, has raised insurance costs and limited the available range of insurance options. These inefficiencies have been an important factor contributing to the rising number of uninsured people.

In three other areas—the provision of health-care information, the enforcement of antitrust laws, and medical malpractice rules—government policy has failed to promote adequately the proper functioning of health-care markets. As a general rule, markets work well when information about product and service prices and quality is widely available. Although recently the federal government has taken steps to disseminate information about health-care prices and quality

to both consumers and providers, much more needs to be done to ensure that health-care markets perform their essential role of promoting lower cost and higher quality.

Markets also work well when vigorous competition among suppliers prevails. Government enforcement of anti-trust laws in health-care markets has been too lax. As a consequence, health-care providers are able to engage in anti-competitive practices that drive up prices and reduce quality.

Finally, markets work well when appropriate penalties are levied on suppliers of deficient products and negligent service providers. Current medical malpractice law imposes excessive penalties that have led to costly defensive practices and higher rates of medical errors.

The first step in solving the problems of the U.S. health system must include changing these policies.

In this book, we propose five reforms to improve the ability of markets to create a lower-cost, higher-quality health-care system that is responsive to the needs of individuals. These reforms are summarized in box 1:

1. *Tax reform*: We propose three changes to the tax code, designed to reduce the distorting role of third-party payers, encourage saving for future health-care needs, and reduce the rate of uninsurance.
2. *Insurance reform*: We propose allowing insurance companies to offer health plans on a nationwide basis, free from costly state benefit mandates and excessive rate regulation, to foster more portable, more affordable health

4 HEALTHY, WEALTHY, AND WISE

insurance. We also propose a subsidy for persistently high-cost individuals.

3. *Improved provision of information*: We propose public/private partnerships to provide better information to doctors and patients.
4. *Enhanced competition*: We propose greater federal scrutiny of anticompetitive behavior by hospitals and other health-care providers and stricter application of antitrust laws when such behavior is found.
5. *Malpractice reform*: We propose malpractice reform to reduce wasteful treatment and medical errors.

We also propose further study of a sixth reform: revocation or limitation of the current tax preference for nonprofits.

In combination, these reforms will reduce health-care costs by approximately \$60 billion per year without reducing the quality of care. These savings will accrue to consumers and workers. Decreases in health spending will lead to decreases in health-insurance costs. And just as increases in health-insurance costs are borne by workers in the form of lower wages, decreases will accrue to them as higher wages.

Cost savings, however, are only one of our goals; our policies will also improve the system's productivity, fairness, and responsiveness. For example, improved health information and malpractice reform will improve quality. Tax reform will make the tax treatment of health expenses more progressive, with the largest gains for low-income households.

Box 1

FIVE STEPS TO A BETTER HEALTH-CARE SYSTEM

1. Health-Care Tax Reform
 - Total deductibility of health-care expenses
 - Expanded health savings accounts
 - Tax credits for low-income individuals and families
2. Insurance Reform
 - Nationwide portable health insurance
 - Subsidized private insurance for the chronically ill
3. Improve Health Information
 - Expand the number and scope of report cards on doctors and hospitals
 - Promote use of “best practices” through guidelines
4. Control Anticompetitive Behavior by Providers and Insurers
5. Reform the Malpractice System

Reducing wasteful spending and inefficient regulation will reduce uninsurance. We estimate that our reforms will provide insurance to at least 6 million—and perhaps as many as 20 million—currently uninsured people. (The wide range of that estimate reflects the considerable uncertainty about the effects of various policies on the uninsured.)

These reforms will also gradually but fundamentally give individuals more control over and choices for their health care. Most notably, tax deductibility and health savings accounts reduce the financial penalty for purchasing medical care directly rather than through employer-provided

insurance. Consumers will respond by shifting the type of insurance they purchase to lower-cost catastrophic insurance and away from first-dollar coverage. As the availability of health-care report cards and other user-friendly information devices increases, consumers will become better equipped to make health-care decisions, and as consumers spend less on insurance premiums and more on direct medical-care purchases, health-care providers will become more responsive to their demands than to those of insurance bureaucracies.

Nationwide insurance and reduced mandates will expand the number of insurance choices available. In conjunction with more vigorous enforcement of antitrust laws against health-care providers, this enhanced competition in insurance markets will reduce the cost of insurance for everyone, but likely most for nongroup markets in rural areas where coverage options are currently narrow. Tax credits, by providing additional health-care resources to persons with low and moderate incomes, will make health insurance more financially attractive and broaden their insurance options. As coverage increases and more relatively healthy individuals join health-insurance pools, the range of options will continue to expand, and the cost will decline further.

At the same time, our policies will not abruptly alter the existing system of employer-sponsored health insurance. As we describe below, the tax reforms we propose retain significant incentives for employers to provide health insurance. Our proposed reforms benefit the individual and the employer market alike. We are agnostic about the ultimate balance that should be struck between individual and

employer-based insurance; to the extent that they are efficiently able to pool together persons with different health-care risks, employers should continue to provide insurance. However, we firmly believe that this balance should be determined by market forces seeking to deliver the care that individuals want—at the cost they are willing to pay.

Our book proceeds in three chapters. In chapter 1, we outline the challenge facing public policy: retaining and continuing to achieve gains to society from the U.S. health-care system while minimizing its costs, both financial and otherwise. Chapter 2 proposes a market-based approach to accomplishing this goal, explaining why the most important problems with our health-care system are in large part due to five flawed public policies, and showing how five sets of specific reforms can correct these flaws. Chapter 3 quantifies the expected consequences of our reforms, based on estimates of how consumers and providers have responded to past changes in markets for health care, and explains how we calculate their effects on health spending, the uninsured, and the federal budget.