

Incentives in Healthcare: The System's Broke; Let's Fix It

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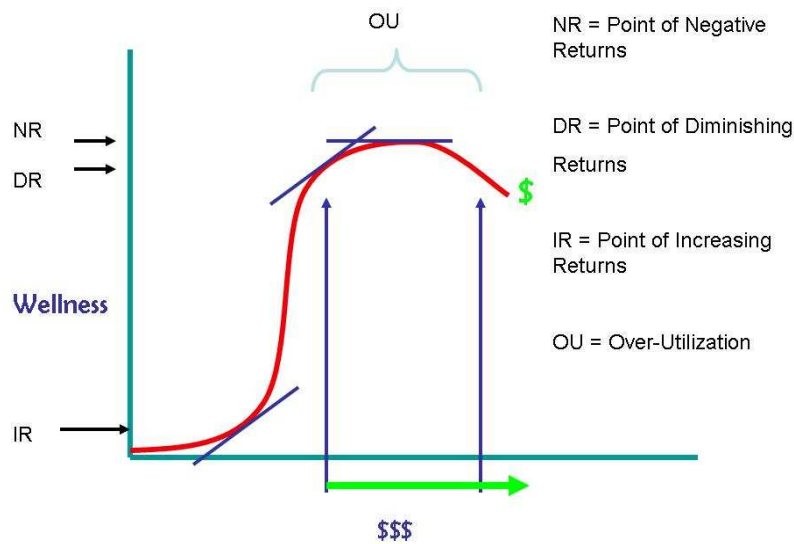
*Wealth is not interesting; shortages are interesting.
Health is not interesting; death and disease are interesting.*

When I was still in high school I had a job working for a very clever man who ran a drugstore. He taught me how he made money - and he made a lot. When a customer came in and needed a decongestant for a cold he persuaded them that a combination antihistamine-decongestant would be better, and he was sure they felt miserable (he was always so sympathetic), so some aspirin or Tylenol would help, and he would reach for these himself always choosing the product with the greatest mark-up, and of course some Kleenex would be absolutely necessary - a larger box was a better bargain. You get the idea. Profit motive in healthcare.

When a patient enters a hospital the same thing happens. Much of what goes on is simply up-selling. But the up-selling goes on before the patient has any say in the matter. The doctors are sold the newest gadgets, the administrators are sold the newest gadgets, the nurses, pharmacists, radiology and pathology departments are sold the newest gadgets. Then the patient pays for the newest gadgets. This isn't news. It's just my way of saying that up-selling is common in medical markets, therefore... (You fill in the blank.)

Wellness – The Return on Investment

When I taught healthcare policy we discussed the following graphic. It shows the standard model for Return on Investment. In this case, however, the return is not in dollars, but in Wellness. It is a great model for medicine and applies to every level of the system.



As I said, this model works at every level. When we invest dollars in medical services we anticipate Wellness in return.

For the cost of a small smear of neosporin and a band-aid a child's scraped knee will heal faster, but in order to provide those things Mom has to buy a whole tube of neosporin and a whole box of band-aids. She buys more capacity than she will immediately use. So the initial investment is always a little greater than the initial return on wellness. But now she can treat several knees.

Similarly, an ICU does not stand-alone. It must have an available lab, x-ray department and pharmacy. Someone has invested in the capacity to provide ICU services to not just one individual, but to several. So to reach the point of Increasing Returns there must be some investment in Capacity. Once that capacity is in place, however, multiple lives are saved and we see the return in wellness at nominal cost.

Returns on Wellness increase dramatically when the appropriate infrastructure is in place. Vaccines don't magically appear in vials, but once the infrastructure is in place to make vaccines and put them in vials, the cost per vial is minimal and returns of Wellness, from both a wellness and a financial standpoint, are phenomenal. The same goes for many other medical services.

And so we feel justified in spending on medical care right up to the point of Diminishing Returns - where we get a dollar's worth of Wellness for a dollar invested. And maybe we spend a bit beyond if we have the money to spare, aiming for some spot just before the Point of Negative Returns.

But Americans are now spending well beyond the point of Negative returns! For a variety of reasons, we find our selves in the situation of paying twice as much as we need

for approximately the same level of wellness. John Kitzhaber, former Governor of Oregon, addressed this in a recent talk. He points out the perverseness of financial incentives in the U.S. healthcare system. I agree with him that part of the solution lies in changing incentives.

But spending beyond the point of Diminishing Returns, at least in our present system, is often removed from the hands of consumers. Consider prescription v. generic drugs. Suppose I could get comparable Wellness with either. Suppose my doctor is simply biased against generics. You already know this one. I spend more money for no more Wellness. (Are doctors the culprits? Are hospitals? Is big Pharma?)

Suppose I am a doctor trying to rule out an acoustic neuroma and I give a patient a choice between an MRI or a repeat audiogram in one year. (As an otolaryngologist, I wear this hat all the time. I can count on my thumbs the number of times the patient has chosen the repeat audiogram.) (Is this defensive medicine or consumer directed care or simply over-utilization?)

Over-utilization

Regarding over-utilization, we do it all the time and for a variety of reasons. We all know we ought not do it, but there are simply too many incentives to continue doing it; it is easy and very profitable. Hospitals incent patients and doctors alike to over-utilize.

Purveyors of new gadgetry raise the "community standard" for the level of care in order to justify additional tests, non-generic drugs and more technical procedures - it's profitable!

Once again, regarding the level of Wellness, does my hospital want me to be at the level of Wellness when I first reach the Point of Diminishing Returns, or - think about this for a minute - does my hospital have an incentive for me to be at the same level of Wellness as at the first point of Diminishing Returns, but paying for it on the right hand side of the curve as it turns down? (See that nice green arrow at the bottom of the figure? That's cash!)

And when my hospital tells me that this level of Wellness "unavoidably" costs this higher amount, what am I to do?

Furthermore, does my insurance company find some perverse pleasure in this? If my insurance premium costs are proportional to my financial risk, then the greater my financial risk, the greater the value and the higher the price of my health insurance premium. I have got to find a way to reduce the cost of medical services to the cost of production at the first Point of Diminishing Returns. And, this has to be done in aggregate; it must be done on a community scale or it will be of no benefit to me as an individual.

The market may not be working the way we think it ought to work, but is working predictably. After all, markets are accountable for profits and not wellness.

To lower both the cost of medical services and the cost of health insurance, one of two things must occur. Either we eliminate the market and set fees (a solution proposed by single-payer advocates), or we find a way to tell the market "you may have profits only if you produce wellness and do it at or near the cost of production."

We need to change the incentives in the market. Why? Because insurers are selling a product to mitigate financial risk and not a product to improve wellness. Asking the health insurance industry to improve efficiencies and lower costs in the medical services industry is tantamount to asking the insurance industry to ring its own death knell. Let's face it; if medical services are not expensive, health insurance ain't worth squat.

The current response of the health insurance industry is not to eliminate waste in the production of medical services; it is simply to refuse to pay for those services. Insurers accomplish this by shifting high costs onto consumers, employers, hospitals and doctors, but still leave costs high and with tremendous waste in the system, all the while pointing the blame finger at providers.

In fact, insurers increase waste in the system by requiring an ever increasing burden of paperwork from providers at every level. Estimates of the cost of waste in the medical services industries at this level are staggggging. (Paper shuffling in the American healthcare system has become its own legend and its own industry!) No wonder citizens and policy makers and presidential candidates alike scurry about looking for a new way of doing business.

Alternatives are tough. If eliminating the market means the adoption of a single-payer system (a publicly sponsored not-for-profit health insurance product) and making all other insurance products illegal, it also means forfeiting the accepted advantages of market systems as they apply to healthcare. Tough choice.

But, retaining the private market for primary health insurance with these new kinds of incentives will mean an entirely new playing field for insurers. This represents a paradigm shift of tremendous magnitude. In the new paradigm, the health insurance industry will become profitable when, and only when, it produces Wellness at the cost of production.

The Cost of Production and a "Normal" Market

How does one identify the cost of production? Simple. Place the commodity of interest on the market! A NORMAL MARKET!!!

How does one identify "normal" market? Simple.

A uniform product.

A universally available product.

Perfect knowledge of product and price.

Easy entry to the market.

Price sensitivity.

NO RESTRICTIONS ON BUYERS OF THE PRODUCT. (Anyone with the price of the product can buy the product.)

If you think these parameters do not apply to health insurance, you're right! Insurers complain that theirs is an over-regulated market. But the reality is that it is an overly protected market.

Five policies would both protect patients AND change the health insurance market into a normal market. These are:

CHOICE. Americans need a choice between a public plan and private health insurance plans. If people have a choice between a publicly sponsored not-for-profit health insurance plan and a private health insurance product they will be able to shop for their health insurance based on where they find true value in healthcare coverage. (The easy entry of one more supplier into the market!)

MANDATORY ENROLLMENT. There are two ways to accomplish Universal Enrollment: 1. Default enrollment and 2. Mandatory enrollment. If everyone is enrolled in the publicly sponsored not-for-profit plan by default then we will have accomplished universal enrollment.

Many people prefer private coverage; if these people are allowed to opt-out of the public plan they may do so, but they may not opt out of healthcare coverage altogether - they may not become "free riders." This produces two favorable changes in the current system. First, everyone is covered and people with health insurance will no longer subsidize ER visits for people without coverage. Second, this works favorably for the health insurance industry because they can substantially reduce underwriting costs when everyone is covered - they no longer face the issue of "adverse selection." Because of these two effects, Mandatory enrollment will lower health insurance premiums.

COMMUNITY RATINGS. Everyone shares; everyone benefits. This does not just mean that we distribute the cost of medical care across the population; it also means that we distribute the cost of medical services across a lifetime. I don't know about you, but I intend to get a lot older than I am now. Under the present system I could sooner or later be priced out of health insurance coverage, and so could every young person out there - even after just one serious illness. Community ratings means insurers cannot raise your premiums based on your health history. If you get sick, you cannot be priced out of coverage.

GUARANTEED ISSUE. Means that insurers must accept any applicant for health insurance. Even though you may have default enrollment in a public plan, this means that if you prefer private coverage you cannot be denied - regardless of health history.

(This distinction may appear subtle, but for lower income people it is huge. Guaranteed issue means you cannot be denied coverage; community ratings means that you cannot be priced out of coverage. Every single-payer system, like Canada, has both community rating and guaranteed issue.)

UNIFORM BENEFITS PACKAGE. A Uniform benefits package accomplishes two things. First it assures a standard level of care for everyone. Second, and perhaps more importantly, it persuades insurers to compete based on price. Imagine that all insurers offer the same minimum benefits package. Imagine you are shopping for health insurance and you know that all insurers (the public plan as well as all private insurers) offer the same benefits package. Do you imagine that insurers will now compete based on price to get a substantial market share? Do you imagine the price of health insurance will fall? (Ask the Dutch. They performed this experiment in 2006. It worked!)

One more note about **UNIFORM MINIMUM BENEFITS PACKAGES.** The opposite of a uniform benefits package is called "Price and Product Differentiation," When you read the information at AHIP.org¹ you will find all kinds of language persuading people that the worst thing that could ever happen to Americans would be a uniform benefits package.

The folks at AHIP know perfectly well that as long as they can offer different benefits packages at different prices it will be hard for you to shop for health insurance based on price alone. Indeed, it will be almost impossible for anyone to shop for health insurance based on price when they must choose from an ever more dizzying array of different health insurance products

CHOICE

The mantra of AHIP is: "One size doesn't fit all." They recite, "Americans want Choice." But they will spend hundreds of millions of dollars to make sure there is one choice you never have - a publicly sponsored not-for-profit health insurance plan!

Imagine two future scenarios. One is the single-payer scenario. The other is a multi-payer scenario with both a private health insurance industry and a publicly sponsored not-for-profit health insurance plan. In either scenario we have a publicly sponsored not-for-profit health insurance product. If you are faint of heart, sit down. I'm going to use the "C" word, "Crowd-out." There, it's on the table. The possibility of Crowd-out will generate tremendous incentives in the private health insurance industry to lower premiums.

Only when such a product - one that is sensitive to the population's natural aversion to

¹ An organization called America's Health Insurance Plans (AHIP) (found at www.ahip.org) is an extremely wealthy and powerful association of health insurance companies. They have a specific agenda. It is clearly stated. Every member has signed on. Every member knows what to say and when to say it. (Language from the AHIP agenda even shows up in the recent Lewin Report to the Colorado Blue Ribbon Commission on Healthcare Reform.) AHIP is a well oiled machine.

taxation - is finally available will the private insurance industry have the incentive to produce medical services at the cost of production and not simply deny claims or deny coverage in order to contain costs. Only when faced with such a system will the insurance industry confront the profit incentives associated with over-production and over-utilization inherent in our present system. Only when a publicly sponsored not-for-profit health insurance product is available to everyone can citizens truly shop for value in healthcare.

And only when clients have the option of moving into a public plan and abandoning the private insurance industry will the private insurance industry wake up and realize that it must become at least as efficient as the publicly sponsored plan if it wants to remain profitable - or remain in the market at all! Only then will the private insurance industry place the necessary pressures on the medical services industry (note the intentional distinction between the two industries) to produce medical services at the first Point of Diminishing Returns. Only then will they finally have any incentive to lower the cost of a health insurance premium.

The biggest hurdle to reducing the cost of medical services to the cost of production is the AHIP agenda. But when Americans see the potential for cost reduction in both medical services and health insurance they will gasp in amazement. The key to sustainability is Choice - a choice that includes a publicly sponsored not-for-profit health insurance product (with default enrollment). Without that choice an oligopoly will continue to dictate who is insurable and at what price. Without that choice, America and all American industries will remain at the mercy of insurers.

Read more about the relationships between Choice, Mandatory enrollment, Community ratings, Guaranteed issue, Uniform benefits and "Normal Markets" at:

http://www.chroniccrisis.com/Position_Statement_on_Healthcare_Reform.pdf

<http://www.amazon.com/Chronic-Crisis-Critical-Collapsing-Healthcare/dp/0979253195>

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