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Consumer-Focused Competition Needed in Health Care

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Everyone has something that they don't like about health care. Business owners are alarmed at rising premiums. Employees don't like rising deductibles or changes in coverage and fear losing insurance altogether.

Regina Herzlinger, a professor of business administration at the Harvard Business School, knows the industry from the inside out. A senior fellow at the Manhattan Institute for Policy Research (www.manhattan-institute.org), Herzlinger first wrote a book on the subject back in 1997. Her latest book is "Who Killed Health Care?"

It opens with an assessment that the health care system is in "a ferocious war," with doctors—the closest thing a consumer has to a friend in the industry—losing out to health insurance companies, hospitals, and governments. Economic, financial and scientific disasters will come to the country should any one of these three come to dominate health care.

Herzlinger advocates consumer-driven care. Sometimes that approach is assailed as a cover for companies or governments to dodge their responsibilities. But the question—"Who controls my health care dollars?" —can be a matter of life and death. Herzlinger constructs a portrait of a fictional patient who dies of kidney failure to examine the role of five "killers," including general hospitals, employers, Congress, and academics.

Managed care, which makes up the bulk of health insurance these days, leads off the list. Kaiser Permanante typifies the best, and worst of managed care. The best came in its older days, she says, when the company had "soul." I was a bit baffled at that, but the stories of the company's recent mistreatment of kidney transplants are certainly damning.

Next up are general hospitals, which Herzlinger estimates are responsible for half of all excess spending on health care in the country. The cause is not their expensive technology but their antiquated management that forgoes opportunities for cost-reduction. They preserve their antiquated ways through vertical integration ("owning" all the required resources, including physicians) and mergers. Hospital mergers alone have increased the number of people who can't afford health insurance by nearly 5.5 million people between 1990 and 2003, according to Herzlinger.

Employers, meanwhile, serve as the default vehicle of insurance, though they don't do a very good job at it. Though consumers enjoy a great deal of choice in casualty insurance, about 90 percent of all employers offer but one choice in health insurance. That's not adequate to serve the diverse interests of employees very well, though it does simplify matters for the HR department.

Employers are in the insurance business because it is now a business necessity to retain employees. That's because thanks to the federal tax law, employer-sponsored plans have preferential treatment over individually purchased plans.

Congress, meanwhile, practices medicine when it decides how patients in Medicare should receive kidney dialysis. Its impact is more widely felt when, at the behest of general hospitals, Congress squashed specialty hospitals. Herzlinger is a great fan of specialization, including "focused factories" of health care.

Academics, the final "killers," provide the intellectual justification for putting health care in the hands of anyone but the consumer. Herzlinger singles out two motivating beliefs: "business is evil" and "consumers are dumb."

Where Now?

Some health care reform call for bigger, better government programs. Others favor health savings accounts and high-deductible insurance policies. This latter approach is one element of "consumer-driven care," which generally opposes laws that require individuals to obtain insurance.

Herzlinger clearly doesn't fit into the first camp. While her approach is compatible with the second, it deviates from it by calling for a legal requirement that every person be covered by insurance.

Though there are sound reasons for placing the onus of a mandate on individuals (as Herzlinger does) and not businesses, doing so plays into the hands of single-payer advocates who would tar Herzlinger as a tool of business.

To level the playing field, Herzlinger calls for individuals being given the same tax advantage that employers get when it comes to purchasing insurance. A key insight here is that insurance, like wages, is a form of compensation. As a matter of morality and economic efficiency, employees rather than employers ought to control how that money is spent.

Rather than ramp up public programs, Herzlinger calls for giving the poor public subsidies to use in a private insurance market, which is being used in a few places in the country. In many states, private markets need a substantial overhaul to eliminate required benefits. One innovation Herzlinger offers is that consumers and insurance companies should be able to enter into five-year contracts. The idea is to give insurers a longer-term stake in consumer's health.

What I found most important in this book is the emphasis on the supply side, where Herzlinger calls for both more and less regulation. Specialty hospitals and convenience clinics, for example, should be free to operate. On the other hand, she would require providers to publish prices for their services and create an organization, along the lines of the Securities and Exchange Commission, to audit those statements. Considering the mess that Sarbanes-Oxley has made of American corporate life, the value of yet another government agency could be questioned. And perhaps due to her admiration of doctors, Herzlinger says little about the restrictions on physician supply endorsed by the AMA.

The average total premium for an employer-sponsored family insurance plan now tops $12,000 a year, according to the Kaiser Family Foundation (www.kff.org). “Who Killed Health Care?” offers many reasons why consumers ought to have more control over how that money is spent.