# The Devil's Advocate: Incentives, previous reforms raise health care costs

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Once upon a metaphor, seven economics geeks went to The Chimes to discuss health care reform.

Agreeing to pay for their meals individually, each wonk only bought food if it was worth more to him than the price. If one geek valued the blackened salmon at $9, then it was worth buying at $7.50. A full rack of baby-back ribs — perhaps valued at $12 — would not be worth its $22 price tag.

In the language of economics, the costs and benefits of the decision-making were fully “internalized” — no one exported his bill, and no one stole food from others’ plates. Without these “externalities,” individuals make decisions that match their preferences.

If the waitress had adamantly refused to keep track of multiple checks and the seven wonks decided to distribute the cost evenly, things would have been less fair.

Each geek would enjoy the benefits of each item while only having to pay for a fraction of its cost. Adding the blackened salmon would cost a little more than a dollar, but adding a full rack of ribs and the best imported beers would only cost $3 more. It would be irrational for any individual wonk to restrain himself. Before long, the group will be stumbling home drunk, bloated and broke.

Whenever people can export their costs, the result is wasteful spending. If you want society to efficiently distribute resources, then you should support policies that minimize externalities — or at least oppose policies that encourage externalities.

America’s health care system is an all-too-real example of wasteful spending. Of our country’s medical spending, 30 percent creates no value at all, according to Michael
Cannon of the CATO Institute. This means 6 percent of our gross domestic product is pure, make-work waste.

I have two worries about proposed reforms. The first is that it will lock us further into a system that encourages waste.

The goal of insurance is to spread risk. The health “insurance” most Americans have — and many can’t afford — not only pays for disasters, but also pays for everyday medical expenses. This creates negative externalities just like at the restaurant table.

Flood insurance only pays in catastrophes — not every time you mop the floor. If it did, you’d probably waste a lot more water.

“If the tax exemption for employer-provided medical care and Medicare and Medicaid had never been enacted, the insurance market for medical care would probably have developed as other insurance markets have,” said the late economist Milton Friedman in the winter 2001 edition of Public Interest. “The typical form of medical insurance would have been catastrophic insurance.”

“Claims would be rare and large, as in fire insurance. Premiums would be low, as in fire insurance,” said economist Arnold Kling.

But even ignoring the allocation problem, there’s little reason to believe government reforms can reduce costs.

The last major federal involvement in health care was the 2003 Medicare Modernization Act. Originally promised to cost less than $400 billion during the course of 10 years, by early 2005 the estimate of the 10-year cost had increased to $1.2 trillion — three times as much.

While individuals shopped for the cheapest effective drugs, the federal government explicitly promised not to use its bargaining power to lower the cost of prescription medication.

There’s no reason to believe reforms under Obama will be any different.

Former Louisiana Congressman Billy Tauzin — who co-sponsored the 2003 act — has since become the President of PhRMA, the largest pharmaceutical
lobbying group. PhRMA budgeted $150 million for TV commercials supporting President Obama’s reforms, and Tauzin has been quoted in both the August 4 LA Times and the August 5 New York Times as being very enthusiastic about the deals he has struck with Obama.

To ensure health insurance is affordable, we should stay away from government programs and focus on ways to make health insurance more adaptable to consumers’ needs.

Most states have laws dictating what insurance policies must cover. These raise the average cost of premiums by 15 percent, according to Cannon.

Eleven states have community rating laws which raise the price even further.

An easy fix would be to allow insurance companies to compete across state lines. Most Americans would see an immediate decrease in cost without being taxed an additional penny.

More ambitious reforms might end tax benefits for purchasing insurance through employers. This could give an even playing field to innovative health care models — such as catastrophic health insurance or insurance for the development of pre-existing conditions.

In an ideal world, individuals would purchase health care in a way that doesn’t distort behavior or increase taxes.

Obama’s plan may bring everyone to the table, but my wallet would prefer we just eat on our own.

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