- The Daily Caller – Breaking News, Opinion, Research, and Entertainment - http://dailycaller.com -

Tyler Cowen's uneasy case for managed care

Posted By Alan Reynolds On Wednesday, March 17th, 2010 @ 2:17 PM In Opinion, Opinion:Lower Section | No Comments

I am usually a big fan of George Mason University's innovative economist Tyler Cowen. But something peculiar seems to come over free-market fans when they start writing for The New York Times. Case in point: Cowen's "Managed Care: Get Used to It [1]."

Here are some excerpts, followed by my comments:

> Cowen: "Some forms of managed care – health maintenance organization like Kaiser Permanente, for example – have been accepted by broad segments of the population. But the obvious downside of managed care is that a provider may be stingy with service and access, precisely because "fee for service" treatment is limited. In the 1990s, many patients rebelled, objecting to bureaucratic decision-making and long delays for "optional" services. It is still with us, however, and its role is certain to grow."

Certain to grow? Among employer-sponsored plans, HMOs had only 20 percent [2] of the market in recent years, down from 31 percent in 1996. That loss of market share is remarkable since Kaiser pays no income tax, unlike nonprofit Blue Cross Blue Shield plans.

> Cowen: "All managed care plans have a built-in incentive to limit costs, because more treatments do not automatically mean more revenue for health providers. . . During managed care's heyday in the early 1990s, inflation in health care costs was much lower than it is now."

Annual increases in the consumer price index for medical care were 3.2-4.4 percent in 2003-2009, and 5.9-9 percent from 1990 to 1993. Inflation in health care costs was much *higher* in the early 1990s than it is now.

> Cowen: The real challenge is to change our fundamental attitude toward health care . . . The question is not managed care versus the status quo, but which opportunities — and the restrictions that go with them — we are prepared to accept. . . We may not like it, but third parties — the government and insurance companies — won't be able to pay for all the care that people desire. Yet the aging of the population will ensure that medical costs will spiral."

That "we" refers to an extraordinarily diverse group of people who share no common "attitude." Cowen's approach assumes the only alternative to having government or insurance companies pay *all* the bills is to invite managed care experts (a death panel?) to decide who gets what sorts of health care.

In reality, free people should be free to choose to

1. pay providers directly, or
2. pay premiums to insurance companies who then take a cut before paying providers, or
3. pay taxes to the government which then takes a bigger cut before paying providers, or
4. pay taxes to the government which then pays for somebody else's medical care. What Obama calls "reform" would stomp out the first and most efficient option, but hugely expand the fourth.

Aging raises the odds of higher medical expenses. But aging need not ensure that seniors are entitled to have taxpayers pay the bills. Approaching 68, I would love to be allowed to opt out of Medicare A, as I do with B and D, and also be relieved of the Medicare tax, past and future. My "opt-out solution" would greatly alleviate the demographic projections. I'll sign a binding promise to never use Medicare (or Medicaid) if they'll just refund my half of the Medicare tax, without interest.

Cowen's non-price rationing scheme would be needed only if too many American voters allowed themselves to be put in the position of Blanche DuBois, who "always depended on the kindness of strangers."

> Cowen: "We need to think carefully about how to say no without breaking the better side of our health care institutions. For all the complaints, managed care does not seem to hurt actual health care outcomes, whether pertaining to life expectancy or recovery from disease, according to a series of papers by David Cutler . . . and co-authors."

Cowen asserts that HMOs do just as good a job in some technical sense (unrelated to consumer satisfaction) yet are much cheaper (than what?). Yet employer-sponsored plans have abandoned HMOs in droves. So, Cowen thinks he sees an unbelievably huge market failure: In a $1.2 trillion private health insurance market, sophisticated corporations supposedly waste hundreds of billions paying for literally nothing, so their employees end up underpaid without demanding HMOs.

In the informative book "Code Red [3]," David Dranove notes that "there are only two ways that you can reduce spending on anything: you either pay lower prices or buy less stuff." The decade-old finding of Cutler, McClellan and Newhouse, he notes, "is hard to reconcile with prior studies showing that HMO strategies like capitation reduce quantities." In fact, Cowen's whole argument for managed care collapses if HMOs were *not* more inclined to "say no." As he said, "the obvious downside of managed care is that a provider may be stingy with service and access." If so, patients suffer needlessly or die prematurely.

As Cutler and McClellan [4] show, the health benefits from new health technologies typically exceed their admittedly higher costs. There is often a conflict between saving money (saying no) and saving lives.

HMOs do negotiate deep discounts from hospitals and drug companies, but so do PPOs. The

studies that Cowen cites by Cutler and co-authors did *not* compare HMOs with PPOs, but with "traditional" fee-for-service indemnity policies [5] (which have almost disappeared). Even in that case, Cutler found that "greater incidence of disease [6] in the indemnity plan" accounted for half of the cost gap with HMOs. Prices are also higher for indemnity plans than PPOs, not just HMOs, because such plans let you pick doctors and hospitals and therefore can't negotiate better deals with preferred providers. To compare costs of HMOs with antiquated indemnity plans is using a straw man as the target.

> Cowen: "For all of managed care's problems, national bankruptcy would be considerably worse, and that's where we're heading if we don't rein in health costs. . . In addition to the financial burden of Medicare and Medicaid, rising insurance premiums in employer-provided plans are absorbing a large share of what might otherwise be wage increases. That makes us poorer and keeps us from buying safer cars, eating healthier food . . ."

National bankruptcy means sovereign debt risk from excess government spending and borrowing. It has nothing to do with employers somehow forcing workers to accept an allegedly excessive share of compensation in benefits rather than wages. If accepting PPO health benefits "makes us poorer," wouldn't more people gravitate toward jobs with HMO benefits, or none at all?

And if Medicaid threatens national bankruptcy, how does it make sense for Medicaid to be signing-up more millions non-poor people?

> Cowen: The Obama plan would move in this direction. Many people receiving new health insurance coverage would be enrolled in Medicaid, which already relies on managed care for about half of its patients.

Why stop there? If only we were *all* on Medicaid, then half us might also be shoved into HMOs "like it or not." Why? Because first-rate doctors don't have to accept third-rate payment from Medicaid patients. And few do.

> Cowen: "Managed care can be run by the government, as in Britain, or left in the hands of a regulated private sector. Because . . . many Americans are suspicious of government controls, the private route is the most likely option."

He does *not* say the private route is the most *desirable* option, just more likely. Cowen says, "It's far from obvious that Congress . . . will make better decisions." Then he adds an ominous caveat.

> Cowen: "On the other hand . . . some people may be more willing to accept a 'no' answer on health care from a government agency than from a private company. If so, we run the risk of limiting our care choices just because we're more squeamish about one kind of "no" than another."

Cowen provides no persuasive logic or evidence to make me less "squeamish" about being marched into managed care by a government agency with the power to say "no." As long as I am spending *my own money* (or my own work-related benefits), then *how much* I spend is nobody's business but my own.

Alan Reynolds is a senior fellow with the Cato Institute and the author of "Income and Wealth [7]."

Article printed from The Daily Caller – Breaking News, Opinion, Research, and Entertainment: **http://dailycaller.com**

URL to article: **http://dailycaller.com/2010/03/17/tyler-cowens-uneasy-case-for-managed-care/**

URLs in this post:

[1] Managed Care: Get Used to It: **http://www.nytimes.com/2010/03/14/business/14views.html**
[2] 20 percent: **http://ehbs.kff.org/pdf/2009/7981.pdf**
[3] Code Red: **http://www.amazon.com/Code-Red-Economist-Healthcare-Destroying/dp/069112941X**
[4] Cutler and McClellan: **http://healthaff.highwire.org/cgi/reprint/20/5/11**
[5] indemnity policies: **http://www.jstor.org/pss/2600999**
[6] greater incidence of disease: **http://www.economics.harvard.edu/files/faculty/13_acz_final_9-5-02.pdf**
[7] Income and Wealth: **http://books.google.com/books?id=3I_Et2sJm8IC&printsec=frontcover&dq=Income+and+Wealth.&source=bl&ots=F0eb3U4q_R&sig=qp9DwItmPpcrLOvNht-FU8dTZxs&hl=en&ei=04meS4jHHMa0tgeO_YSHBg&sa=X&oi=book_result&ct=result&resnum=2&ved=0CA8Q6AEwAQ#v=onepage&q=&f=false**

Copyright © 2009 Daily Caller. All rights reserved.