Health Care, Heal Thyself

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In his State of the Union address on Tuesday night, President Bush will be able to report that the economy is strong (albeit weakened for the moment thanks in large part to hurricanes), tax relief is working, and education reform is producing results. What else can this president do to define his domestic-policy legacy?

He need not look far. One of the biggest threats to the nation's future prosperity is the continuing explosion in our nation's health-care costs.

Health-care demand and inflation are draining the resources of federal and state government agencies, employers, and the self-employed. Despite our national investment of $1.9 trillion, we get highly inefficient care--spectacular in certain respects, but rife with error, disorganized, and unaffordable or inaccessible to many. About 46 million Americans--one in six--go without health insurance. Six out of ten worry about going bankrupt because of a major illness. Is this the health care $1.9 trillion should buy?

Of course not--and no one thinks so. Last year together with John Cogan and Daniel Kessler of the Hoover Institution and Stanford University, I published a book, Healthy, Wealthy, and Wise, containing five basic policy proposals that would put consumers in charge of America's health-care system, save $60 billion a year, and provide health insurance to as many as 20 million people. These savings and increases in coverage occur through the power of removing impediments to private markets.

We found that many of the problems in our health-care system stem not from what happens in the doctor's office or hospital, but what happens in our tax code. If, on the one hand, an employer pays for an employee's health coverage, it is a tax-free cost for both the company and the individual, therefore allowing for generous health-care coverage in large companies--especially those with union-negotiated contracts. If, on the other hand an individual must pay for health-care costs out of pocket and these costs cannot be written-off, the medical expenses are more keenly felt and are, at times, hard to afford. This difference often results in the person avoiding to seek medical care until it is absolutely necessary--if at all.

Many policymakers are starting to see the problem. Last fall, the bipartisan President's Advisory Panel on Federal Tax Reform suggested capping the tax deductibility of health-insurance premiums so that employers could extend only so much coverage to their workers. And, if we could do so, removing all tax subsidies for health care would be the best answer. That outcome is most unlikely, and the key is to stop the tax bias against low-cost individually purchased health insurance. In our book, we propose making all health-care spending deductible. The difference in those policy suggestions is significant, but the effects would be similar. For once, all Americans would begin to manage the cost of their health care directly, instead of letting others worry about it.

Some conservative critics seem to miss this point. They see in full deductibility of health-care costs a major giveaway to health consumers. Not at all. First, we already over-subsidize health care through tax deductibility--the problem is that the subsidization is highly uneven, and is available generally only for those who work for major employers. By creating a 100 percent, universal health deductibility at the consumer level, no matter where someone works or whether they work, our proposal would give everyone an incentive to demand total control over their health-care dollars, and take that control away from companies and unions.

If patients enjoyed the same deductibility for health-care spending as their employers, they would take greater control over their health-care dollars--and higher deductibles and copayments would reduce overall health spending substantially. (Critics may want to check our empirical evidence on this point--or offer their own evidence to the contrary.) Right now, the insured patient rarely-if ever-sees the actual bill. Even heavy users of health-care services are rarely aware of the true cost of their desire for, say, brand-name drugs over generics. Instead of the vast giveaway some detractors foresee in our proposal, universal health deductibility would drive health-care decisions down to the consumer level, creating efficiencies that are impossible in today's third-party-payer system.

Our proposal would reward discriminating consumers and, importantly, give people a way to profit financially from their own good health.

Full tax deductibility of health-care spending would accelerate the use of Health Savings Accounts (HSAs), which are probably the best thing to happen to health care in a generation. Created by both President Bush and the Republican-led Congress, these accounts allow individuals to create tax-free nest eggs to cover routine out-of-pocket medical costs. Were HSAs to be used more commonly, the same dynamic that determines how most people spend their money--trying to obtain the highest quality at the lowest price--would finally come to American health care. That would reward the best doctors and hospitals, and squeeze inefficiency out of the system.

Critics from the left sometimes say that HSAs put more of the onus of health costs on individuals. Tell that to the 46 million Americans who currently don't carry any insurance. By making such insurance for major medical events--such as emergency hospitalization and chronic illness-more affordable, HSAs and other consumer-driven health-care policy ideas broaden access to essential health care. That will help millions of Americans get the health care they currently can't afford.

A greater focus on consumer-driven health care requires further policy improvements: open and national health insurance markets, so that consumers have more choices in the kind of hospitals, doctors, and insurers they use; greater investments into health-information technology to identify and prevent errors before they occur; and reforms of medical-liability rules, so that good doctors and nurses can practice quality health care without being harassed by nuisance lawsuits.

Again, some conservative critics mistakenly think that federalization of our health-care insurance and regulatory markets would inherently be bad for health care. If one's default position is to fight national markets governed by national standards at all turns, I suppose there's no sense arguing the point. But let there be no doubt that national markets would work. Consider the state-by-state standards for gasoline admixtures--a mish-mash of formulas meant to satisfy environmentalists in California and the northeast, to the detriment of national gasoline supplies and refinery capacity. Think that's bad? Look at state-by-state health-insurance regulations. They are far more complex, and in effect create high insurance costs for captive consumers and benefits for some large insurers who alone can either lobby themselves out of trouble or maintain the product lines that each state requires. A few decades ago, banking was run this way, a situation remedied by national banking reform. Instead of the gargantuan national influence on banking that some feared, we have a true national market for a vital financial service--more choices, more products, and more usage. There are other ways to accomplish insurance-market reform, too, but the key is to promote the availability of low-cost insurance to individuals currently subject to costly state mandates.

These proposals are the kinds of ideas that deserve an airing in the State of the Union--traditionally an opportunity for the president to share his vision with all. Americans already expect innovation from their health-care system--new drugs, technology, research, and cures. Now, they should demand innovation in how we pay for all this quality medicine. Let's make sure we can deliver.

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