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What Health Insurance Can and Cannot Do

Health care reform has morphed into primarily “health insurance” reform. That does not mean that the reforms being discussed are unimportant. Expanding systematic access to health care to all Americans clearly is important. In addition, trying to force insurance companies to provide what they were originally designed to provide, a pooling of the risks and costs associated with catastrophic medical crises, is also vital to make health insurance affordable to all Americans.

One of the frustrating changes in the health insurance industry over the years is that it has gotten better and better at sorting through the population, finding and excluding those who are likely to make significant claims because of expected future health problems. That is where the denial of claims associated with pre-existing conditions came from as well as the practice of canceling insurance policies once a person has had a serious illness. Those are just two of the more the offensive insurance company practices. Insurance companies study your past health records and life style to estimate how likely you are to need medical care and regularly refuse to cover certain people or cover them with only very high cost policies with very high co-payments and deductibles.

That, actually, is a very business-like approach for them. If you can identify high-cost customers, why wouldn't you try to avoid them or charge them more? But that undermines the principle of pooling risks so that everyone can afford protection. Other nations that have continued to use private insurance companies as the basis of their

national health care systems, have forced all health insurance companies to offer basic policies to all applicants and outlaw denial of coverage or canceling of policies, forcing all insurers to carry their share of high risk individuals. It seems clear that whatever emerges from the current health insurance debate in Congress will also adopt similar rules, recreating the risk sharing that is at the heart of real insurance.

But there are some things that insurance is not very good at. Insurance works for events that are so unpleasant or threatening that no one would purposely invite them or even act in a negligent way to bring them on. We insure against our houses burning down or being in an automobile accident in which our lives are threatened and our cars are totaled. Likewise, we insure against debilitating illness or accident, the medical costs of which we could not hope to pay and would bankrupt our families. In all of these, the financial costs are just a small part of the damage involved. There is also the pain of loss of our family's home and our treasured possessions or the pain of injury and illness and the loss of our capacity to live a normal life or to continue living at all.

Insurance is possible against the costs associated with things that no one would willingly bring down on themselves. Insurance against the costs of normal daily activities is not practical. We cannot buy an insurance policy against getting hungry that would allow us to go into any restaurant and eat anything we want at no cost to ourselves. We cannot insure our clothing against normal wear and tear. But many of us expect any "good" medical insurance policy to pay for almost all of our medical expenses, whether those are routine costs that everyone faces or medical expenses we choose to take on to improve our appearance or performance.

When we know that someone else will pay the costs associated with choices we make, we behave differently than when we know we will have to pay those costs. This is the problem of moral hazard. In general, we do not want to allow an individual to shift the costs associated with her or his own behavior on to other parties. That is both unfair and an unsustainable incentive system. It encourages personal irresponsibility, hence the name, moral hazard.

For a variety of historical reasons and well-meaning public policies, we have created a health care finance system in which none of the principle decision makers have a direct interest in the cost of the treatment being sought, not the person seeking the medical treatment and not the doctor or nurse providing the care. That arrangement can be praised for removing monetary considerations from the provision of life sustaining care. But when applied to routine medical treatment, it assures an endless cycle of cost increases because no one is responsible for controlling those costs. It is no different from offering food or clothing or fuel or entertainment for free on a routine basis.

One solution to this problem would be to assure that everyone in the nation has catastrophic health insurance at a low cost tied to the real pooling of all health risks. People would be expected to handle almost all of the costs of routine health care themselves. That would focus insurance where it works, where moral hazard problems are much reduced. Tax subsidized medical savings accounts could encourage individuals and families to maintain savings for routine medical expenses. Medicaid could continue to provide access to routine medical care for low-income kids and

families. Where public health concerns justify easy access to certain preventative care such as vaccinations and medical testing, they too could be directly subsidized.

This may not sound much like health insurance reform at all since it builds on the system that we already have in place. But we have to be careful to keep our eyes on the real objective. Our primary focus should not be on health insurance reform but on health itself, protecting and enhancing our health. Pouring more money into health insurance programs that fund a system that is not focused on protecting and enhancing our health at all but on treating our medical problems once we are seriously ill is unlikely to solve any of the our actual health problems. In addition continuing the arrangement where all major decision makers are oblivious to cost will assure that it will be financially unsustainable. Worse yet, it will not cure the major and growing threats to the health of our population.

There are important changes that need to be made in our health insurance system. But that is just the beginning of the reform effort that is needed actually to improve our health.