REPERCUSSIONS *By Gerard Smedinghoff*

Why All Health Reform Measures Are Doomed to Fail

The British sometimes like to joke that giving the English language to the Australians is a bit like giving sex to children. They know it's important; but they don't quite know what to do with it. The same warning applies to politicians and economics, especially with respect to health care reform. In Greek, the technical definition of the word *idiot* is "one who shuts his door and does not go out into the marketplace." In present-day English, *idiot* is usually used as an insult. Yet, stripped of its pejorative connotation, it's an accurate description of those who persist in attempts to foist upon us health care reform and socialized medicine.

In economic terms, there are three major problems with health insurance. First, policyholders make no quantifiable initial investment in their health. People insure their cars and their houses for what they paid for them or their current market value. Yet, when it comes to health insurance, everyone is covered for the same—i.e., essentially infinite—amount, even though many people actively and purposely spend time, money, and resources on behaviors, substances, and lifestyles that sabotage their health (in other words, moral and morale hazards).

Second, there's no universal standard definition for one's health. Many, if not most, medical services, from prescription drugs to radiation therapy to bypass surgery, are open to question—even within the medical profession itself. For annuities and life insurance, there's a simple dichotomy: The policyholder is either alive or dead. But health insurance guarantees a vast array of medical services, thereby providing a tremendous opportunity for repeated and uncontrolled policyholder antiselection.

Third, the economic exchange of health insurance comprises premiums, denominated in currency, from the policyholder to the insurer, paid in exchange for the unspecified and continually fluctuating value of health care services. It is of no concern to a life insurer what a $100,000 death benefit will be able to purchase in the future when the policyholder eventually dies. But for a health insurer, the future cost of the surgical procedures and hospital services covered in its contracts is always changing, and can make the difference between emerging as an industry leader and facing insolvency.

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Despite all this, health insurers are able to develop the requisite variety to survive and prosper in this environment, so long as they keep their focus on the principle of an actuarial equivalent exchange of value, by keeping the policyholder's premiums in step with the market value of the health care services guaranteed in their contracts.

But many of the efforts at health care reform we've witnessed over the past months—at both state and federal levels—that move in the direction of socialized medicine ignore all this. They abandon the notion of value-for-value exchange by attempting to fix both sides of the equation. They seek to fix both the premiums paid by the population and the benefits they're entitled to, without realizing that their values—like all other economic goods and services—are in a continual state of flux.

Whatever the market determines health insurance premiums to be, politicians always deem them to be unacceptably high. And whatever level of health care services the public receives, they're always considered insufficient. Politicians, who make a living catering to the ever-present whining of the "more from them and less from me" variety, believe they can intervene and fix the health care sector of the economy, as if it were an engine in need of an oil change and a tune-up. But economics isn't a machine, an automated programmable system, or a fixed equation that produces a quantifiable solution. If it were, prices would never change, the economy would never expand, and new technologies wouldn't threaten established industries.

In fact, economics is a *discovery process*. As we deplete more of our natural resources without replacing them, we *discover* that the price of these resources rises. When Xerox introduces the office copier into the marketplace, we *discover* that the market for carbon paper shrinks dramatically.

Well, then, what must the masterminds behind any health care reform effort require to achieve success? Five distinct needs must be filled:

- requisite and relevant information on how the health care economy functions
- projections into the future as to what their vision of the nation's reformed health care system would look like
- expertise and legal power to assure that their measures are enacted
- a way to effectively alter the behavior of the public's health habits and how it consumes health care services
- a political consensus that will guarantee the cooperation of all the actors in the health care economy.

Not surprisingly, lurking within each task is a minefield of obstacles big enough to block successful implementation of any health care reform mea-

sure. Let's examine them from an economic context.

Information—Fighting the Messenger

The same information can often have opposite effects on different groups of people. In economics, most information is both good and bad—depending on your position at the time. Rising interest rates please lenders, but annoy borrowers. This is no reflection on the ethics or morals of borrowers or lenders; it's just a simple axiom of economics that every seller prefers a higher price to a lower one, while the reverse holds for every buyer. Economic information is simply organized data expressed in a coherent form.

Note that the status quo, direction, and momentum of the environment are indifferent to your current position (although many of us would like to believe there is a conspiracy operating against us). And just to make life interesting, we're powerless to predict or guarantee the factors in any environment in the future.

Of course, owners of IBM stock would prefer that its price double in the next 12 months. And some people would like to peg the price of a $200 deductible comprehensive medical insurance policy for every citizen far into the future because they think universal coverage is a noble public policy objective.

But wishing won't make it so, no matter how many actuarial formulas you have at your disposal. Professional expertise and *intu-ition* eventually degrade into desperate *intu-wishing*, as even the most intelligent observers fail to properly assimilate economic information from the surrounding environment. Testing one's financial savvy by picking stocks or gambling with one's personal funds at the race track is a private matter. But practicing this sort of whimsical intu-wishing on a large scale, as most of the health care reform measures would do, is gambling with other people's money and livelihoods while denying any responsibility for the consequences or any obligation to pay it back.

Projection—Inductive Proofs Don't Apply

Every household, business, and government must make projections about the future. The two keys to succeeding in this area are accuracy and the ability to react quickly to any deviations from initial expectations. Since professional economists have a wretched track record with respect to accuracy, we can safely assume that no one has superior expertise here. As for the ability to react quickly, the more variables you're in a position to adjust, the better able you are to react. The major problem with most health care reform measures is that they're locking into place not just one, but two of the key economic variables—the benefit package and its cost.

How do economists make their projections? Since today is pretty much like yesterday, they naturally assume that tomorrow will be pretty much like today. Once this pattern has been established to their satisfaction, they implicitly (and erroneously) think they can apply the principle of induction and assume that the situation 10 years from now will also resemble today.

But what, in fact, will be the cost of a chest X-ray at a medical clinic in Cincinnati, a gall bladder operation in Albuquerque, or a Caesarean delivery in New York on, say, April 23, 1998? The reason you can't predict specific numbers is that prices don't align themselves with dogma, rules, or principles; they're simply information—like the headlines in today's newspaper. Fixing prices in the future is just as hard as fixing the news in the future. And it makes no difference whether you own a printing press or have unlimited amounts of time, unlimited resources, and an unlimited budget.

Projection by induction also fails because it assumes that factors are infinitely multiplicative and, conversely, infinitely divisible. Just because you can buy a head of lettuce today for 98 cents (or provide comprehensive medical care for a single uninsured person at a cost of $175 a month) doesn't mean that every U.S. citizen can buy as many heads of lettuce as they please for the same 98 cents for the foreseeable future. This is like trying to make a baby in a month by assigning nine women to the project.

Pension actuaries are aware of this trap. When they calculate the assets

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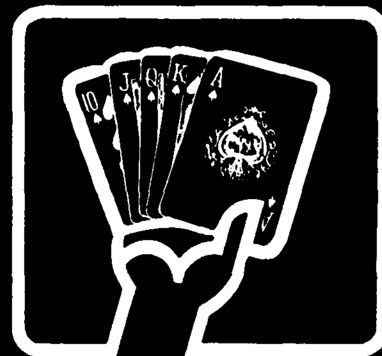

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Perhaps Hillary Clinton, with her stellar record of trading in the futures markets, is the person most qualified to enact such sweeping health care reform measures. All she has to do is take what she's previously done successfully for a brief period of time, on a minute scale, with one variable (i.e., cattle), and replicate it onto a macroeconomic environment with thousands of interacting variables, across the entire nation, and project her predictions forward for the next two generations. Unfortunately, the intelligence required to solve such an enormous economic problem is probably limited to those who can create a universe in 6 days.

Don't Believe Everything You Write

It's best to approach the economic environment as you do the weather: Take a reactive stance and accept the fact that you can't control it. In constructing a house, every detail can be planned by one person, the architect, but in economics the converse is true—the opinion and actions of one person are almost always so insignificant that no one has an indicator microscopic enough to measure their effects.

Insiders with specific knowledge, professionals of one sort or another who possess superior talents, and corporate titans who wield unchallenged power in their respective industries continually fall prey to the illusion that they can transfer the expertise and influence they wield in the tiny sphere of their work to the grand stage of economic behavior in the marketplace. But there, every opinion and every decision interacts, in innumerable ways, to form a cumulative entity of the market for goods and services that no one person can control or predict. It's as if the local weatherman decided that he could combine his superior knowledge of meteorology with his amateur experience as a Shakespearean actor, and could call up thunderstorms at will by doing his weather forecast on the evening news dressed as King Lear.

Case in point: Millions of dollars of advertising hype, backed by overwhelming data from consumer taste tests and focus group research, proved that *New Coke* was superior to the traditional version. But when the New Coke finally hit the mass market, it wound up as the Edsel of its generation.

Those who think they can reshape the health care economy in the direction of socialized medicine mistake the ability to propagate opinions and preferences—oftentimes within reach of *idiots* who quickly succumb to delusions of grandeur—for the power to control market information, which has always eluded even the most powerful kings and generals.

Attempts to reform the health care sector by adopting some for of socialized medicine should include the warning, "Don't Try This in the Marketplace!"

Marketing: *De Gustibus Non Est Disputandum*

Adding to the complexities of any attempt to accurately monitor and price each and every aspect of the health care delivery system is a major marketing phenomenon that powerfully skews these economic calculations: People are much more willing to pay for goods and services they actively experience than for those they passively receive.

This common error of economic application results from two tendencies. First, the *fallacy of common perception* assumes that we all assign the same values to various items. Consider the range of perception among consumers for basic products like a pack of cigarettes, a pork chop, a bottle of whisky, and oat bran. The people most actively promoting health care reform probably value these items in precisely the opposite way as many of the people to whom they want to guarantee coverage.

The *fallacy of absolute values* assumes that buyers and sellers make their decisions based on the absolute values of quantifiable data such as price and delivery date. Yet, a cursory examination of your own spending habits shows that you make economic decisions based, not on absolute values, but on what's called the *first derivative*—a simple comparison of where you are now versus where you'll be after making the purchase.

Food, movies, concerts, clothes, and vacations are all goods that are consumed in the state of *active participation.* Contrast that with *passive-recipient* products like electricity, gas heat, insurance, and gasoline. In buying a movie ticket or a meal in a restaurant, people experience an immediate and obvious change in their physical and mental state after the purchase. But they experience little or nothing when they pay their utility and insurance bills. To experience the coverage from your insurance policy, you must take the time and make the mental effort to think about it. And this form of torture has been outlawed by the Geneva Convention. So the first derivative for active-participation products is enormous compared with the total void of experience for passive-recipient ones.

Note further that the products in the active-participation group have wildly fluctuating prices, which generate very little disturbance among consumers. Congressional committees don't convene when, say, the price of lobster or a season's football tickets soars by double digits overnight. Not so with passive-recipient products. After Iraq invaded Kuwait and the world oil supply was disrupted (and a child of four could easily understand why gasoline prices were on the rise), the U.S. Senate held hearings to find out why drivers had to pay higher prices at the pump.

In fact, consumers object to discontinuities in the price of gasoline because their concentration is focused on

their automobile, an active-participation product, not the gasoline hidden in the tank. In their view, they already purchased the right to drive their car when they paid for it; buying gasoline to fill up its tank is like paying a tax on something they already own.

They object to paying for health care for the same reason. They take good health as a given, so spending money on attaining it is like paying for something that was already theirs to begin with. From the public's perspective, as passive recipients, the only reasonable and acceptable price for health coverage is "free."

Producers, marketers, and distributors of passive-recipient products like insurance or health care could profit from spending some time pondering this point. The key to overcoming the marketing, selling, and service barriers to passive-recipient products is to somehow (1) make your customers and potential customers actively experience your product and (2) make each such experience a pleasant and, if possible, even a pleasurable one. That's why so many HMOs (among other providers) feature newborns in their print and television ads: The birth of a baby is the only health care encounter where the customer leaves with a new toy to play with, something she can actively experience.

Politics—Is Health Care a Right?

The fundamental error committed in the economic application of health care reform is to mistake an environment of top-down leverage and coercion for one defined by mutual agreement between unencumbered parties. Your relationship with the government, for example, is one of leverage and coercion. If you don't do what the law says, you face a fine or imprisonment. Not so in the marketplace. If you refuse to pay the sticker price for a new car or the list price for a refrigerator, the salesperson can't fine or arrest you.

Keeping the concepts of leverage and coercion in mind, consider the Constitution and the Bill of Rights; note that the rights granted therein to U.S. citizens require no action or obligation on the part of anyone else. Rights like free speech and the right to vote are not defined in an economic context, because no price is attached to them; no economic exchange of value is required to exercise them.

In contrast, when politicians and policy wonks assert that health care is a right, they're asserting that rights come in the form of goods and services, which have a measurable market value. This is no different from saying everyone has a right to a chicken in their pot and a car in their garage. If you have a right to a good or service, that requires that someone else has an obligation to supply it. In the realm of politics, rights are free; in economics, one person's right is another person's servitude.

This question of rights and liberties, with respect to the procurement of the talents and labor of others, was settled more than a century ago. As Abraham Lincoln noted, "With some, the word liberty may mean for each man to do as he pleases with himself and the product of his labor. While with others, the same word may mean for some men to do as they please with other men and the product of other men's labor . . . . And it follows that each of the things is by the respective parties, called by two different and incompatible names: liberty and tyranny."

Healthy Respect for Economics

The Vienna Philharmonic, in a flawless performance of Beethoven's Ninth Symphony, or the former May Day parades in Moscow, are certainly elaborate and aesthetically beautiful orchestrations of human achievement. But don't mistake them for displays of economics in action. They are the products of command-and-control dictatorial power structures. If you want to see what economics looks like, *visit* the trading floor of the Chicago Board of Trade. And I stress the word *visit.* Don't cash in your 401(k) in case you think you might spot an opportunity you can't pass up. Like the television commercials that attract attention with dramatic stunts, attempts to reform the health care sector by adopting some form of socialized medicine should include the warning, "Don't Try This in the Marketplace!" □

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