MOTHER OF INVENTION: HOW THE GOVERNMENT CREATED "FREE-MARKET" HEALTH CARE

Robert I. Field

Published by Oxford University Press

PREFACE

"Keep the government out of my health care." That and similar refrains have permeated health policy debates in the United States for over a century. Opponents cried "socialized medicine" when reformers first tried to create government-financed health insurance plans in early part of the twentieth century. They raised the alarm again when President Harry Truman proposed universal coverage in the 1940s, when President Lyndon Johnson proposed Medicare in the 1960s, and when President Bill Clinton put forth his comprehensive reform plan in the 1990s. It is by now a familiar call, and it has often achieved notable success in defeating or forestalling reforms.

The rallying cry was proclaimed with special stridency in recent debates leading up to passage of the Affordable Care Act, the massive health reform law enacted in 2010. Opponents charged that the law amounted to a "government takeover" of the health care system. They argued that American health care is doing just fine and may even be the best in world. Why let the government in? It can only mess things up.

Underlying these concerns is an ongoing debate over the relative merits of the government and the private market in delivering and financing health care. Over the years, researchers in academia and think tanks have conducted countless studies and analyses to compare the efficiency, effectiveness, and compassion of both sectors. Often, they compare America's market-based system to those of Europe, where governments play a more pervasive role. What would happen, they wonder, if the government ran health care in the United States? How would things be different?

The problem with these debates is that they miss a key point. The speculations about government-run health care, both positive and negative, are largely for naught. There is no need to guess about the possible effects of letting the government take over the American health system because it already has.

Take any component of health care in the United States. Its most visible manifestation is likely to be a collection of private companies, many owned by outside investors, doing business with the public and earning profits in return. But look a bit closer and what appears to be a uniformly private sector is revealed as a mosaic of private and public elements. The government's hand is everywhere.

This book examines four such health system components, arguably the four most important. The first is the pharmaceutical industry, which is comprised almost entirely of private investor-owned companies. They create a stream of new products in response to market pressures in an environment that can be highly competitive. Their enterprise and initiative has made them among the most profitable in the country over the past two decades. Yet the ultimate source of innovation for these engines of profit is a massive federal program – the research funding of the National Institutes of Health (NIH). With a budget of almost $30 billion a year, it creates much of the raw intellectual fuel on which the industry thrives. That fuel takes the form of advances in basic biomedical science that makes virtually all of the industry's new products possible.

The second is the hospital industry. The government owns only a small minority of American hospitals. The majority operates as private corporations, some on a for-profit and some on a nonprofit basis. They represent a significant economic presence in cities and towns across the country and offer an ever-growing array of technologically advanced services. This sophisticated care is extremely expensive, so much so that it is out of the financial reach of most patients. Payment from insurance plans is the only viable source of funds, and the government administers the largest single plan in the form of Medicare. Without it, few hospitals in the United States could survive in their present state.

The third is the medical profession. America's complement of physicians is dominated by specialists who earn more than their colleagues almost anywhere else in the world. Once again, they have the Medicare program to thank. It not only reimburses practitioners for much of the high-end specialty care they deliver at generous levels but also helps to fund their training.

Finally, there is the private insurance industry. It has grown over the past several decades from a niche player into a major force in the financial sector with huge national corporations playing dominant roles in many markets. They would not exist but for the guiding hand of federal policy. Government decisions shaped the industry in its formative years in the 1930s and 1940s, and government subsidies support it today to a considerable extent with a substantial tax break for coverage provided through employers. Government programs also account for a sizeable share of the industry's overall business by offering private insurers the opportunity to administer coverage under Medicare and Medicaid and by creating and subsidizing a huge market for individual policies sold through insurance exchanges under the Affordable Care Act.

None of this is news to those who work in these components of the health care industry. Pharmaceutical researchers readily credit NIH funding as the backbone of the research enterprise that creates new drugs. Hospital executives carefully plan their service offerings and medical staff composition around the intricacies of Medicare reimbursement rules. Physicians in many specialties fill their practices with elderly patients who turn to Medicare to cover their bills. Insurance executives vie to market policies to employers that can then offer coverage to workers as a tax-free benefit.

However, the size and pervasiveness of the government's role is news to many, perhaps most, people outside the industry. They directly see the private face of health care in their routine interactions with the system, while the government foundation that lies beneath it remains opaque. As a result, they perceive a market-based system that operates apart from the public sphere. To be sure, few are oblivious to the substantial government role in regulating every component of American health care. The list of agencies is extensive, and the actions of many of them – such as the Food and Drug Administration, the Centers for Disease Control and Prevention, and state departments of health – routinely make the headlines. But regulation is commonly perceived as an external force that holds the private health care system in check, rarely as an integral intricate part of that system.

This book aims to change that perception. It demonstrates how a system that seems so clearly rooted in the free-market in fact rests on a huge partnership between the public and private spheres. The government does much more than simply oversee an industry built by private entrepreneurs. It is the primary source of guidance and funding on which almost every aspect of that system relies, and it has played that role for well over half a century. Without it, "free-market" health care as we know it today would not exist.

The notion that private markets grow from a foundation of government initiatives is not new. Observers have noted it for as long as there have been private markets to observe. The father of free-market economic theory, Adam Smith, commented in the late eighteenth century on the key role of several kinds of government infrastructure in enabling markets to function. More recently, economist Joseph Steiglitz described the importance of public support in underpinning much commercial activity. Even Milton Friedman, the champion of laissez faire economic policy, noted that private firms need some forms of public intervention in order to thrive.

The phenomenon of public support for private markets is widespread and hardly limited to health care. In fact, it pervades the entire economy. This book

begins by noting the connection between government programs and the growth of four major industries. The Internet enabled personal computing to grow from a curiosity into a mainstay of the entire economy. Interstate highways transformed the automobile from a convenience to a necessity. The space program launched satellites on which the cable television industry relies to transmit content. Mortgage support programs led to an explosion in housing construction (although with less than auspicious results in recent years).

However, in no industry is the link between public initiatives and private enterprise as close as it is in health care. The government directly funds the provision of over half of all medical services in the United States. When indirect support through tax breaks and other means is considered, the total is closer to two-thirds. And the portion continues to grow. Those funding programs carry with them innumerable conditions that determine the shape of American health care at all levels – from the structure of giant corporations like pharmaceutical firms and for-profit hospital chains to the nature of private physician-patient encounters. Without the government, the health care industry in the United States would be unrecognizable.

This book tells this story through statistics on growth trends and through case studies of prominent private health care players. All of the sectors that it considers predate government involvement, in some cases by thousands of years. However, the size and shape they take today emerged from a crucible of public policy and financial support. Each is now dominated by huge private enterprises that owe their prosperity, and often their very existence, to a partnership with the government of one kind or another.

Government intervention in support of private markets can take different forms. It can, for example, provide funding through subsidies, both directly with grants and indirectly with tax breaks. It can facilitate commercial activity by building and maintaining essential infrastructure. It can encourage business relationships by establishing and enforcing regulatory standards that enhance consumer trust and set the ground rules for fair competition. And every level of government can initiate such efforts - federal, state, and local. However, regardless of the form, it is public policy that is driving private initiative, and the book considers the government's role broadly to reflect its range of incarnations as they apply across American health care.

The tale of each sector ends with a thought experiment that considers what that industry segment would look like had the government not intervened. The answers are, of course, conjectures that are highly speculative. We can never know with certainty what form an alternative health care world would have taken.

However, we can wonder what other player could have provided the resources and national perspective needed to create modern health care. And for each sector, such a player is hard to imagine. We would be hard-pressed to find models of any major industry that reached its present size and vitality without a government initiative of some sort, and there is no basis to believe that health care could have been an exception.

Of course, to identify the driving force behind our system is not to uncritically praise it. The American health care system leaves much to be desired, and many of its shortcomings can be traced to the very government programs that created it. The system falls short on each of the key determinants by which policy analysts measure effectiveness. Quality is inconsistent, with wide variations in practice across regions and an epidemic of errors that are a constant cause of patient harm. Costs perennially rise at an unsustainable rate, now eating up more than 17 percent of the nation's overall economic output. And access is limited for tens of millions of people who lack insurance coverage, many of whom remain uninsured even under the Affordable Care Act.

Aside from these obvious shortcomings, government initiatives by their nature also create substantial inefficiencies. In particular, the private industries they have nurtured use their substantial government-granted resources to lobby their sponsor for ever-growing levels of support. Once an industry gains sufficient size, it can translate its wealth into political influence, and the government often finds it impossible to control what it has wrought. A clear example is the behavior of providers that rely on Medicare for their financial stability. Hospitals, home health agencies, outpatient clinics, and numerous medical specialties, among countless others, continuously lobby Congress to maintain the flow of reimbursement. They do not obtain their objective every time, but they succeed often enough to add substantial costs to the system for services that sometimes offer little benefit. The effects can be seen in a surfeit of hospital capacity, an imbalance in the composition of the medical profession in favor of specialty care, and excessive use of sophisticated technology.

The government's oversight of health care is also subject to what political scientists term "regulatory capture." This occurs when the entities subject to regulation gain enough power to control their own overseers. They use this power to soften regulatory supervision and to tilt its focus away from safeguarding public wellbeing and toward protection of their economic interests, for example by shielding existing firms from new sources of competition. And, of course, government regulators can also be susceptible to outright corruption.

Economists describe the effects of these inefficiencies as "rents," a term that denotes the excess price that a producer can extract by holding a favorable economic position. A monopolist, for example, can extract rents from consumers by charging prices that are higher than those that a competitive market would permit. Health care providers can extract rents in several ways. For instance, they can leverage a favorable position in a regulatory framework that limits competition by enforcing restrictive licensing rules, and they can collect generous reimbursement in a framework that guarantees high payments, as do some aspects of Medicare. When rents are extracted, resources are diverted from more productive uses.

Free-market advocates often hold up this inefficiency as proof of the inherent inability of the government to effectively guide private enterprise. They point to the massive waste of resources and redirection of effort away from public goals to argue that government intervention in markets, however well meaning its original intent, invariably harms societal wellbeing. Left alone, they argue, markets deliver needed goods and services in the most efficient way possible.

From the other side, critics of private health care markets charge that they are wasteful and inefficient. They point to the large profits many firms generate that are paid as dividends to investors and as high executive compensation. These substantial sums represent overhead expenses that leak from the system. They inflate costs without adding anything to the amount or quality of care that patients receive. Critics have dubbed the economic engine that generates these expenses the "medical-industrial complex" to denote the capture of our health care system by corporate interests, focused more on financial gain than on patient wellbeing.

The purpose of this book is not to debate the relative merits of private markets and government programs in providing Americans with health care. Rather, it makes a very different point. Free-markets and government regulation do not represent a dichotomy of opposing forces that contend one against the other but rather manifestations of the same underlying dynamic. In a broad sense, free-market entrepreneurs and government regulators are partners in a common enterprise. To be sure, businesses and their government overseers regularly spar with one another, and their relationship is commonly characterized by intense antagonism. But these contests generally center on short-term concerns. Across a range of major industries including health care, in the longer-term, one side could not exist without the other.

Private health care markets do not arise in the absence of government. They arise because the government created them. Free-market advocates may be correct in their observation of inherent and pervasive government inefficiency, however their solution of less government involvement is misguided. If the government stepped

aside, the private health care industry would not find itself in a world of expanding horizons. It would encounter a world in which it would be difficult or impossible to even survive. To speak metaphorically, the government tills the field in which the private market takes root and blossoms. Without it, the field would sprout weeds. We would have plant life, but it would not be of a kind we would want.

Much of the nurturance that tends the field for private enterprise take the form of basic infrastructure that makes commercial activity possible. This book describes several forms that this infrastructure takes in health care. Basic biomedical research, for example, is a public good with benefits that are available to all. It also serves as an essential ingredient in pharmaceutical innovation, but no private firm could afford to invest in its production on a broad enough scale to meet its own needs because the payoff is too speculative and the results too difficult to shield from competitors. Health insurance for the elderly is difficult for private insurers to provide because the risk of expensive claims is too high, yet without it hospitals would have no means of payment for a large portion of their patients. Medical education provides us with a steady supply of new physicians, yet the cost would be prohibitive without some form of external support. And reassurance of the public in the quality of the drugs they take, the hospitals in which they receive care, and the physicians who treat them requires an external objective source of oversight that only the government can provide.

The critics of government are correct that such elements of publicly created infrastructure can be extraordinarily inefficient and susceptible to undue influences. The partnership with private industry that created American health care is riddled with examples of each. Yet, removing government from the equation would lead nowhere. Suggestions to that end serve as a facile response to the system's shortcomings that neglects the enormous complexity of the actual workings of health care. Meaningful reforms must follow a more arduous path. They require that we identify specific elements in need of repair, craft reforms with sensitivity to the corrupting influences that can misdirect them, and build on our ingrained public-private partnership to implement them.

The last chapter of the book considers some specific steps along these lines. It does not contain a prescription for easy solutions or a manifesto for change along a specific path but rather an approach to reform that takes into account the intricate nature of the system as it actually exists. Meaningful reform is rarely accomplished with a quick fix. More than anything, the book is intended as a resource for advancing the discussion over what that change should be by explaining how we got

the health system that we have and how we can realistically understand possibilities for reform.

The intricacy of our public-private system and difficulty of remediating its shortcomings is demonstrated with particular poignancy by the arduous gestation and complex framework of the Affordable Care Act. Dubbed "Obamacare" by its opponents, it serves as an easy target for their criticisms because of its massive size and mind-numbing complexity. However, for all of the dramatic changes that the law implements, it represents anything but a break from the established paradigm of American health care. To the contrary, it is entirely consistent.

Before considering possibilities for further reform, the final chapter considers the Act's place within health care's underlying paradigm. The overriding goal of the law is to expand coverage so that they everyone is guaranteed access to insurance regardless of health status. It does not achieve universal coverage, but it substantially reduces the number of Americans who are uninsured. The simplest and perhaps most efficient way to accomplish this goal would have been to create a government program that provides coverage directly. Advocates of a single payer financing system have been promoting that approach for decades. However, we have gone too far down the road toward a public-private structure for such an approach to succeed politically. Instead, the Act channels substantial new government involvement along the same lines that it has for decades by creating a foundation that enables the private sector to do the job. It accomplishes this by establishing insurance exchanges through which private insurance companies sell policies to individuals and through an expanded Medicaid program, much of which is administered by private insurance plans.

The ultimate lesson to be drawn from America's public-private health care partnership that led up to and that includes the Affordable Care Act is that the two sectors do not compete in a zero-sum game. Growth in the size of one does not detract from the size of the other. When the government expands its role, private activity is not crowded out. Rather, expansion of either sector creates more room for the other. Historically, more government involvement in health care has invariably broadened the range of opportunities for the private sphere. And by the same token, a smaller government role would cause the private sector's prospects to decline.

The United States does not have either a free-market or a government-based health care system and should not endeavor through reform to try to create either one. Government is the only viable source of direction and funding for key segments of health care, and private enterprise is an efficient source of essential innovation and vitality. The notion that there is an incompatibility between the free-market and

the government in the health care system's orientation distorts public debates and misdirects policy analysis. To ignore this dynamic is to ignore the true nature of American health care and to fundamentally misunderstand the opportunities for reform.

On a broader level, political debates are misguided when they pit the virtues of the free-market against those of government oversight. Regulatory programs represent more than an ongoing contest between opposing forces, and public policy does not have to choose sides. Most private industries would not approach their present size or take their present form without the government initiatives that created the infrastructures on which they rest. For its part, the government could not operate these industries on its own without creating massive new inefficiencies.

An understanding of the true nature of this relationship can lead to more accurate perceptions of what truly drives America's health care system and of how policymakers can productively address its serious challenges. In doing so, it may add a new element of rationality to policy debates. At the least, it can refute the rallying cry of keeping the government out of our health care, which has distorted public discourse for far too long. Perhaps it can also put an end to reckless scare stories that "death panels" and "rationing" lurk within government initiatives, which poisoned debates over the Obama health reform plan. To achieve meaningful results, further reform of American health care must focus on ways of improving government policies, not of eliminating them. If we were to get the government out of health care, we might find that we do not have much of a health care system at all. This book endeavors to explain why.