# Restoring "True" Insurance

**Frank Timmins**

The jury is in and the verdict has been given. For decades, insurance has been grossly misused as a tool to manage medical costs in this country. In fact, it has served to promote and support one of the most damaging elements to the medical market: "first-dollar benefits."

Benefits that disguise the actual cost of medical services do great harm to the naturally occurring and self-limiting economic aspects of a buyer purchasing services from a seller. With minimal office and pharmacy copayments of $15 or $20, the insured makes a decision on whether to use the services or drugs without having to consider the cost. This creates what insurers call "moral hazard."

It is very inefficient to hire an insurance company to pay expenses that are relatively certain to be incurred over a reasonable period of time: "budgetable expenses." This seems more obvious with bills for groceries, gasoline, or utilities, but the same economic effects occur with medical bills.

What can we do about this? First, we need to reestablish the true definition of "insurance." Although there are many dictionary definitions, the most concise one is most helpful here: "risk mitigation." One needs insurance if one faces a "risk" of loss, and desires to shift that risk to an entity willing to assume it in exchange for a payment (the premium). What we have come to know as "traditional" health insurance is clearly something else. It would be more accurately described as a very inefficient method of financing medical services.

For medical services, "true insurance" is generally referred to as "catastrophic coverage." We all know that extended in-patient hospital confinements result in expenses that only the wealthiest among us would be willing or able to absorb, and would lead to catastrophic economic hardship in the absence of insurance. This is an example of a risk, and its mitigation is the true and proper function of "health insurance."

This is not mere hair-splitting. In addition to the waste associated with moral hazard, the fact is that insurance companies are terribly inefficient administrators. The logic that demands we not use steam shovels to till our gardens or hand trowels to build roadbeds rings true with the use of insurance as well. Insurance companies are very expensive personal bookkeepers and check writers. In spite of advances in claims–paying software and years of fine tuning, small transactions such as payment of doctor's office charges and related expenses are most problematic. Decades ago when first-dollar coverage became the norm it wasn't such a noticeable waste. Now that the medical sector has grown to almost 20 percent of the gross domestic product it is a very serious waste of resources.

How do we specifically define "catastrophic coverage"? Reasonable persons will disagree about this, and the loss that constitutes a catastrophe depends on the ability of the insured to absorb financial risks. Most visualize catastrophic insurance as a comprehensive health insurance plan (similar to the "traditional" model) with a very high calendar-year deductible (very different from the "traditional" model). For the sake of argument, let's assume the deductible is $50,000.

The immediate objection is that most people cannot afford to fund the first $50,000 of medical expenses in a year. This is no doubt true, but no one is suggesting that the $50,000-deductible policy is the only protection that anyone may or should have. The goal here is to separate "financial management" from the element of "risk" wherever possible, because insurance companies that are capable of providing risk abatement up to millions of dollars are not the best at managing finances on the individual level. No matter how hard they try, elephants will never be able to play the piano.

Consequently, it is irrational to empower these insurance companies with *all* available medical funding in the form of premiums for "first dollar comprehensive medical insurance programs." There are many potential solutions for managing that first $50,000 in medical expenses that would be much less costly than the usual policies available today. This "noncatastrophic" expense is best addressed in terms of financing methods, and creative market solutions can be developed. When financing is not appropriate, one would be able to purchase lower cost "limited" insurance programs that are designed to terminate at the point where the catastrophic deductible is reached. The amount and proportion of self-insuring, financing, and/or purchasing of limited insurance by an individual would be tailored to the specific needs of that particular individual and his family.

A combination of financing and insurance would increase the buying power of the individual, because properly structured catastrophic insurance combined with any appropriate mixture of financing methods should be less expensive than traditional insurance policy costs. It would also tend to alleviate some of the problems associated with medical underwriting for those with health problems, because of the separation of catastrophic risks from the expected expenditures for known health problems.

There are other serious barriers to developing solutions to medical financing problems, the most important being the tax code, which strongly favors employer-sponsored benefit programs. However, changing the mindset about what insurance can and should accomplish so as to reflect economic realities is a necessary step.

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