

# The Key to Price Reduction

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Health plans are expensive because medical care is expensive. The increasing sea of bureaucratic regulations and an entitlement mentality have put a chokehold on true market competition.

Will shopping across state lines for insurance fix that? It's a nice sound bite and will allow the insurance buyers to avoid some of their own home state mandates, but the biggest contributor to the cost of a health plan is the underlying cost of the medical care it finances. Only when there is competition and transparency can costs of care decrease, and costs of health insurance follow.

During the year-long debate before the enactment of the Patient Protection and Affordable Care Act, I did not hear one person ask why medical care is so expensive. Commentators barely even asked why health insurance was expensive, but if 85 percent of the premium for health insurance must be paid out in medical costs, with the new medical loss requirement, and we have not addressed the cost of medical care, then insurance premiums will continue to rise at an unsustainable rate, and even accelerate. Enacting health insurance reform without addressing the cost of medical care is like putting a new roof on a building that crumbled in an earthquake.

## The Role of Federal Price Fixing

The problem starts with a federal agency called the Centers for Medicare and Medicaid Services (CMS). This sets allowable charges for some 14,193 medical procedures (including modifiers). The method, like most government accounting, is based on a complex, arcane formula, which is tied to the elusive codes called Current Procedural Terminology (CPT) codes. The AMA produces and constantly revises the codes, and a secretive committee known as the RUC (the AMA/Specialty Society Relative Value Scale Update Committee) supplies "relative values" for them. AMA then collects licensing fees for these codes from all users, including doctors, hospitals, and insurance billing services.

Altogether, the AMA receives annual income estimated from examination of its IRS form 990 and its annual financial report<sup>1</sup> to be around \$72 million from royalties and products related to these codes, and this amount increased by several million dollars between 2009 and 2010. Insurance companies then use the CPT codes and the Medicare reimbursement rates as a starting point in determining what they should cover and how much they should pay.

In any business model where prices are fixed and paid by a third party at an arbitrarily determined rate, the patient ("consumer") and doctor ("provider") both have an incentive to consume or to perform more services than may be needed in order to gain maximum benefit. Government programs and third-party insurance have become entitlements, rather than indemnity programs. As an alternative, patients could travel to Kansas for a bunionectomy, to New Jersey for a knee replacement, or to Oklahoma for a coronary artery bypass graft, and if you allow doctors and hospitals to compete across state lines with their own rates, then you will achieve fair market rates and sustainable costs.

If a third party arbitrarily decides to pay a doctor in Los Angeles the same as it pays a doctor in Miami, one may be overpaid for certain procedures and underpaid for others, considering that costs differ according to location and state regulations and that the package of services may also differ with physician or institution. Patients will receive "cost effective" procedures, which may not be

what they really need. How many times have you turned on the television and heard a medical supplier offer, "If you have Medicare, we'll get it paid for, or you get your scooter free"? For the consumer, that seems cost-effective. But would you get one if you had to pay \$25,000 of your own money? When both the consumer and service provider are spending other people's money, there is little incentive to control costs. Take your car to a body shop and get an estimate to fix a dent. Then say: "Oh, I forgot to mention, I have insurance." The price will suddenly go up. Instead of using Bondo, the shop supplies a new quarter panel.

## The Role of Competition

So how can we address the costs of medical care? We need to allow doctors and hospitals to compete across state lines, not just insurance companies. To have true competition, patients must see the true cost of the care, and direct their own care. This key element has been completely missed in health insurance reform.

In recent years, an industry known as "medical tourism" has emerged. Deloitte, one of the big four accountancy firms, has projected it to grow at an estimated 35 percent per year. Medical tourism brokers send people overseas with "promised" savings, which compare "billed rates" in the U.S. to "paid rates" overseas. But how are these rates determined?

There often exists a hidden added incentive for these medical tourism facilitators to send you overseas. The facility to which they send you may mark up its price by 20 percent to 80 percent, in order to pay the broker. In the U.S., this is called a kickback or fee-splitting, and is illegal. For this reason, brokers usually won't refer you to a U.S. facility. Deloitte estimates that by 2017 as much as \$600 billion per year in medical care revenues could be lost to the U.S. in favor of overseas facilities.<sup>2</sup> What U.S. patients don't know is that overseas medical facilities are often not competitive on price. When U.S. doctors and hospitals are permitted to set their own rates, they can compete favorably with overseas facilities.

In our lifetime we have seen the loss of manufacturing jobs to overseas markets. More recently computer programming, call centers, and even engineering jobs have followed. There are reasons why wheat is grown in Saskatchewan, and televisions are made in Korea. But despite the World Health Organization's insistence to the contrary, medical care is what we do best in the U.S. We cannot afford to do nothing as our medical jobs are outsourced. We must strike down the price-fixing model in favor of a competitive playing field.

The status quo and the reformed healthcare model lack transparency and financial incentives for both buyer and seller to reduce costs. In order to reduce costs, while encouraging technological improvements, we need to introduce transparency in pricing and allow true market competition among doctors and hospitals.

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## REFERENCES

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