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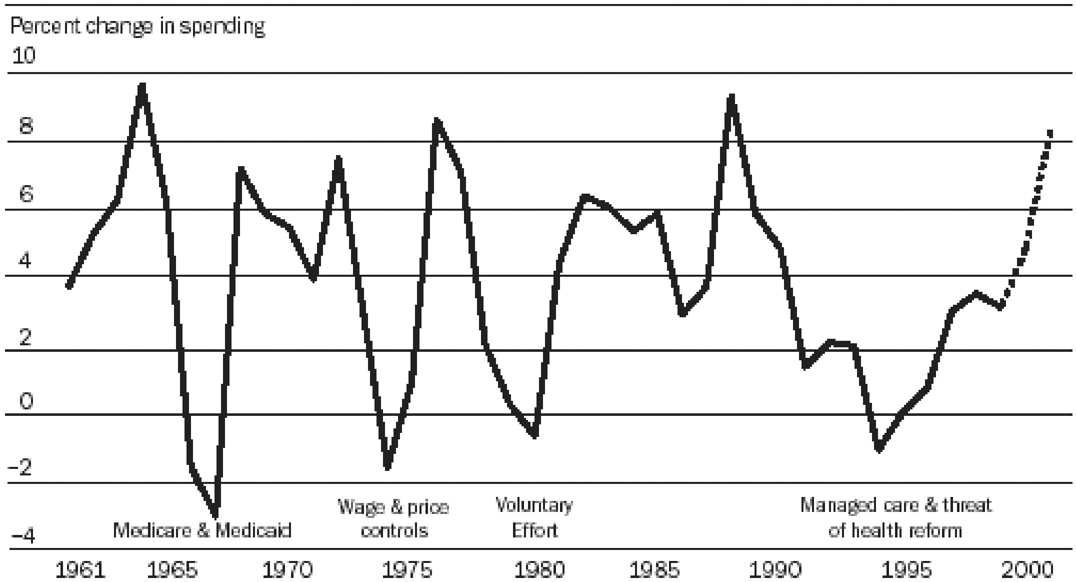
Reforms That Ignore Third-Party Payment Will *Always* Fail to Tame Health Spending

In a recent journal article, the Henry J. Kaiser Family Foundation notes that to date, all attempts at achieving a lasting downward effect on health spending have failed:

> Many lament what they believe has been a failure of managed care to control health costs. That criticism may or may not be accurate or fair, but it is almost certainly shortsighted. What the [nearby chart] shows is that no approach our nation has tried, over the past thirty-five years, to control health costs has had a lasting impact.

All past efforts failed because they did not address the principal reason for escalating health spending: third-party payment. More often than not, American patients are spending someone else's money when they buy medical services.

Annual Change In Private Health Spending Per Capita (Adjusted For Inflation), 1961-2001



SOURCES: Henry J. Kaiser Family Foundation analysis. Private health expenditures per capita, 1960-1999, are from the Centers for Medicare and Medicaid Services (CMS). Change in private spending per capita, 2000-2001, is estimated based on average premium increases for employer-sponsored coverage from the Kaiser/HRET Survey of Employer-Sponsored Health Benefits.

In another recent journal article, Nobel laureate economist Milton Friedman discusses the effect of third-party payment on health care spending in America:

> Two simple observations are key to explaining both the high level of spending on medical care and the dissatisfaction with that spending. The first is that most payments to physicians or hospitals or other caregivers for medical care are made not by the patient but by a third party – an insurance company or employer or governmental body. The second is that nobody spends somebody else's money as wisely or as frugally as he spends his own.

Dr. Friedman estimates that third-party payment caused real, per capita health spending to be double what it would have been otherwise in 1997. The majority of this increase (57 percent) is due to the third-party payment that resulted when federal wage controls and tax policy converged to create the employer-based health insurance system.

How is government, having created the problem of third-party payment, to correct it? Dr. Friedman recommends medical savings accounts:

> A medical savings account . . . eliminates third-party payment except for major medical expenses and is thus a movement very much in the right direction. By extending tax exemption to all medical expenses whether paid by the employer or not, it eliminates the present bias in favor of employer-provided medical care. . .
>
> However, the current pilot program is neither widely available nor flexible. The act limits the number of medical savings accounts to no more than 750,000 policies, available only to the self-employed who are uninsured and employees at firms with 50 or fewer employees. Moreover, the act specifies the precise terms of the medical savings account and the associated insurance.

Were it to make medical savings accounts available to more Americans, Congress would stop the bleeding and finally allow market forces to curb rising health care spending.

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