BY PETER HENDEE

We Are Overinsured For Health Care

MANY AMERICANS HAVE NO HEALTH INSURANCE, and others have limited coverage that leaves them exposed to catastrophic health care expenses. On the other end of the spectrum are people with typical health benefits provided by employers or government programs. Some of these plans require only small copayments for covered doctor visits and other services. Others require payment of a deductible, after which the patient pays a portion of health care costs, such as 20 percent, up to some limit.

Too Much?

How much health insurance is too much? There's no clear line. People have different levels of risk tolerance as well as different life circumstances, and both of these affect how much they protect themselves against risk. People in similar situations often choose to buy different amounts of health insurance and other types of insurance.

Insurance is designed to provide economic protection against significant financial losses that occur by chance. If loss occurs, then the insured gets some financial compensation, the policy benefit, from the insurance company.

Health insurance in the United States has become more comprehensive than other types of insurance. One difference is the type of expenses covered. Table 1 on page 14 lists various types of expenses related to automobiles, homeownership, and health care and indicates which expenses are typically covered by insurance. This comparison illustrates that health insurance covers types of expenses that are not normally covered under other insurance. Some of them aren't significant losses and some of them are under the control of the insured rather than occurring by chance.

Another unusual aspect of health insurance is the probability of having a claim. Figure 1 on page 14 shows typical chances of having a claim under different types of insurance policies. The chance of a health insurance claim is drastically higher than the chance of a claim under the other types of coverage.

The reason health care coverage in the United States has become more comprehensive than other

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insurance is the Internal Revenue Code. A large portion of health coverage is prepayment for routine health care expenses—payment for spending that is normal and expected—on a tax favored basis.

Most compensation is taxed when employees receive it. Taxes are due on money received in the paycheck, on any shares of company stock received, and on personal use of a company car. But compensation received in the form of health benefits isn't taxed. For many people, this means that it costs only $7 or $6 in after-tax pay for their employer to buy them $10 of health care benefits.

This tax policy has failed to provide a minimum level of health benefits to low-income individuals because only people with employer-provided health care get a tax break for their premiums. As a result, the tax benefits associated with health care go primarily to those in the middle and upper income brackets. And minimizing their tax breaks means covering more routine expenses, including dental and vision care. This is so common in employer plans that state laws now require individually purchased health insurance policies to cover routine and discretionary expenses. Thus, while more than 40 million Americans are uninsured, there are probably more than 150 million who are overinsured.

Market Distortion

Government programs such as Medicaid and typical major corporate health plans provide vast amounts of care at little out-of-pocket cost. Many people cov-

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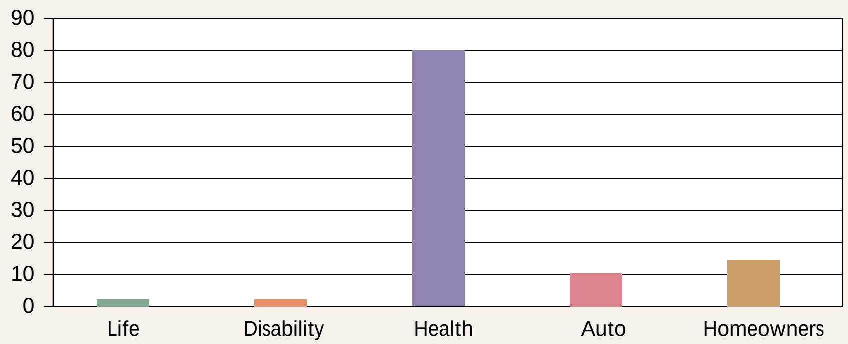
TABLE 1. Coverage Under Different Types of Insurance

Type of Expense	Auto Insurance	Homeowners Insurance	Health Insurance
Catastrophic Events	**Covered** ■ Your car is totaled and must be replaced ■ Someone is seriously injured in a wreck	**Covered** ■ Your house is destroyed by fire ■ Your house is significantly damaged by a hurricane or tornado	**Covered** ■ A life-threatening illness is diagnosed and treated ■ A serious burn results in an extended hospital stay
Unanticipated Events	**Covered** ■ Damage from a fender bender ■ Windshield broken by a rock	**Covered** ■ Property stolen from your house ■ Minor damage from a kitchen fire	**Covered** ■ A broken leg ■ A concussion
Routine & Maintenance Expenses	**Covered** ■ Oil changes and gas fill ups ■ Service brakes	**Covered** ■ Swimming pool maintenance ■ Paint outside of house	**Covered** ■ Well-baby care ■ Office visits for checkups and minor complaints

FIGURE 1. Annual Probability of an Insurance Claim



ered under these plans give little consideration to cost when deciding whether to go to the doctor, even for mild symptoms; their cost for going to the doctor is well below the real cost and value of the services they receive. This behavior, excessive demand, is one of the distortions racking the health care sector.

Another distortion is that providers don't price their services the way other sectors of our economy do. Their primary consideration is maximizing reimbursement from third-party payers - insurers, HMOs, and corporate plans. Health plans set maximum amounts they'll pay doctors and hospitals. So doctors and hospitals set their prices to maximize their revenues. They know that raising prices has little effect on demand for their services, due to the excessive levels of health care coverage under corporate and government plans. It makes sense for them to maximize revenues by raising prices, at least up to insurer reimbursement levels. Thus, health care prices are set bureaucratically and normal market forces don't operate.

People choose their grocery stores and their cars on the basis of the price they have to pay and the quality they get for the price. Supermarkets and car dealers set their prices knowing their customers will be comparing them with their competitors. And people even consider fees when hiring an attorney to write a will. But in the doctor-patient relationship, market forces don't balance the supply and demand for services.

Managed care is an attempt to control health care services from the supply side by giving the providers an incentive not to provide the unlimited care that's demanded. Managed care uses various mechanisms to discourage patients from using health care services. In other sectors of our economy, consumers themselves perform this role of controlling use. People buy other goods and services on the basis of how much they value those services compared to the value they place on other things they could spend their money on.

Managed care is a mechanism for achieving what the market isn't doing. People are insulated from the cost of services at the time they demand and receive them. The market can't allocate health care efficiently because economic incentives, the marketplace interactions of buyers and sellers, have been removed.

An alternative health care financing mechanism is needed, one that avoids the market-distorting drawbacks of overinsurance. And as a practical matter, it should not subsidize mainly higher income Americans.

One possible mechanism is an unlimited health care tax credit. This is only one alternative, and its advantages and disadvantages should be compared with others. It would solve the problems resulting from an unlimited health care tax exclusion: overinsurance with its resulting market distortions and excluding many people with low incomes. The tax credit can provide an appropriate subsidy, even more than many people now get, without encouraging overinsurance. And the tax benefits now enjoyed by people with employer provided health coverage can be shared with people who buy their own health insurance. ●