



[Return to the Article](#)

Reinventing Health Care: The Role of the States

By [David Osborne](#) - February 25, 2009

When the nation's governors gathered in Washington this weekend, many were preoccupied with the largest, fastest growing category of their budgets: health care.

Unfortunately, none of the serious reform plans on the table in Washington attack the three core problems that drive health care inflation: a fee-for-service payment system that encourages waste; a medical system so fragmented that real management of costs is almost impossible and administrative overhead is 25-30 percent; and lifestyles that are creating an epidemic of chronic conditions like diabetes and heart disease.

And without cost control, universal health insurance will not be sustainable. Health care costs have gone up 10 percent a year for 50 years, and they are bankrupting businesses, families, and our governments.

Federal health reform must break this inflation rate--which means it must restructure health care markets. To do so effectively, the federal government will need states as partners. Health care markets differ radically in different regions, so successful reform models will differ from state to state. Federal action should encourage states to experiment, so we all learn what models are most effective in what types of markets.

The most important cost-control strategy will be payment system reform. The financial incentives in our system are backwards. Under fee-for-service payment, providers make more money by performing more services. If a hospital makes a mistake and the patient has to be treated again, the hospital makes more money. If a provider group figures out economical ways to keep its patients healthy, it goes broke.

When doctors' and hospitals' incomes are squeezed, they do more procedures. John Wennberg and Elliott Fisher at Dartmouth University have proven that regions with more doctors per capita have higher rates of hospitalization and procedures--often twice the level of regions with fewer doctors. Yet this higher spending yields worse outcomes! Other studies show the same pattern with Blue Cross Blue Shield insurance.

Wennberg believes that up to a third of the \$2.4 trillion we spend on health care each year is wasted

on unnecessary treatments, overpriced drugs, and end-of-life care that yields nothing.

We need to replace fee-for-service reimbursement with price competition between integrated providers that are paid by the year, not the procedure. They, in turn, should pay their doctors and hospitals lump sums for cycles of treatment for medical conditions--such as nine months of obstetrical care and delivery, or a year's treatment of diabetes.

How do we get there? States could create purchasing pools involving all their programs--Medicaid, the State Children's Health Insurance Program (SCHIP), state and local government employees' and retirees' plans, and others--plus private and nonprofit employers willing to join the pool. (If Congress will allow it, the pool could include Medicare.) States would then invite health plans to compete for this market by offering annual bids, based on both price and quality.

Wisconsin's insurance program for state employees shows how such price competition could work. The program defines a basic benefit package, asks health plans to submit bids specifying the annual dollar amount they would charge for this package, then ranks the bids into three tiers.

Low-price, high-quality plans, ranked in tier one, cost the least for state employees. If employees prefer a tier two or three plan--because their physician is not part of a tier one plan, for instance--they are free to choose it and pay part of the difference. But the vast majority of members choose tier one plans, and this fact creates an incentive for health plans to keep their prices down.

Wisconsin put this approach into effect in 2003. In Dane County, which includes the state capitol, the employee plan covers 25-30 percent of the private market. By 2006, state employee costs for individual and family plans in Dane County had fallen 14 percent below the statewide average and 30 percent below the most expensive regions.

This experience demonstrates that a government can restrain costs by including just 30 percent of the market in its purchasing pool. This is true because most health plans compete for that 30 percent, and when they strive to become more efficient to capture that market, the changes they make affect the rest of their business.

In the average state, government employees and other government-funded recipients total 21 percent of the market. If states could recruit some private employers into the pool and cover at least some of the uninsured, they could easily surpass 30 percent.

Competition for prepaid plans would reward integrated delivery systems, because they are more efficient--easing the fragmentation problem. States could create incentives in the ranking system to encourage plans that still paid doctors and hospitals on a fee-for-service basis to switch to lump sum payments for packages of care. They could also reward health plans for joining statewide electronic health record systems, offering disease management for people with chronic conditions, promoting evidence-based medicine, and other measures that improve quality and lower costs.

Another significant driver of health care costs is our behavior: smoking, drinking, drug use, diet, lack of exercise, and the like. Our leaders should pick the top five behaviors that undermine health and lead massive public campaigns to change them. To offer but one possible tactic, imagine a Healthy Lives Trust with the power to define the food and beverage products that create the most harm and levy fees

on them based on the amount of health-care spending they generate.

If we do nothing to control health care spending, it will consume half of state revenues and almost half of federal revenues within a decade. If that happens, universal health insurance will be a mirage.

//

David Osborne, co-author of [Reinventing Government](#) and [The Price of Government](#), is a senior partner at the Public Strategies Group.

Page Printed from: http://www.realclearpolitics.com/articles/2009/02/reinventing_health_care_the_ro.html at February 18, 2015 - 01:28:41 AM CST