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The Ills of America's Health Care System: Root Causes and Potential Cures

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Sidney Taurel**

I'm delighted to be a part of this very special event.

When I look at my distinguished fellow panelists, I recall a comment Mark Twain once made when he found himself sharing the podium with a famous educator.¹

“Between us,” he said, “we cover all knowledge. He knows all there is to know, and I know the rest.”

Seriously, the breadth and depth of the group you've assembled today is unusual. Together, we may not cover all knowledge. But we should be able to provide some interesting perspectives on health care in the U.S.

Also, your timing couldn't be sharper. Problems in our health care system, and proposals to solve them, are very much top of the news now.

In fact, I'd like to use as my point of departure the latest health care reform proposals from the Bush administration.²

In his current budget, the president is asking for new legislation in several key areas.

He wants to expand the use of his new Health Savings Accounts by making premiums tax deductible and employee contributions exempt from the payroll tax.

He wants to offer these accounts to many who are now uninsured by creating a refundable tax credit for low-income workers to purchase HSAs.

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¹ The other panelists were: Michael B. McCallister, President and CEO of Humana Corporation; Larry C. Glasscock, Chairman, President and CEO, WellPoint Inc.; Daniel F. Evans, Jr., President and CEO, Clarian Health Partners; and Ralph F. Hake, Chairman and CEO, Maytag Corporation.

² See Office of Management and Budget (2006).

He is asking for new legislation to enable consumers to shop for the best health insurance values in a nationwide market.

He is asking, again, for medical tort reform.

And finally, he wants to accelerate the adoption of information technology in health care, including creating electronic medical records for most Americans by 2014.

This is, to put it mildly, a far-reaching agenda, with enormous consequences for our society. Ultimately, to be able to evaluate these remedies, we need to better understand what ills they are trying to cure.

So what I want to do today is go a bit deeper and try to lay out some of the reasoning behind the proposals.

If I can push the disease analogy a bit further, I would say the U.S. health care system suffers from three serious ailments--a metabolic disorder, an autoimmune disorder, and a cognitive disorder.

The metabolic disorder is really an economic problem. As the intake and utilization of food drives the performance of the human body, so does the intake and utilization of funding drive the performance of a health care system.

People with certain metabolic disorders may overeat, because the chemical signals that usually tell the brain when to eat and when to stop are out of balance.

A similar malfunction is at the heart of the endless cost spiral in U.S. health care. There is a breakdown in the economic signals between buyers and sellers where, normally, price is the balancing mechanism. In health care that exchange never happens because one party--the patient--needs and consumes the medical service, while another party--the government, or my employer, or the insurance company--appears to pay for it.

I say "appears," because economists would argue that, in one way or another, consumers do bear the cost. But, because we think of it as "somebody else's money," we feel little inhibition about spending it. "Feed me," the consumer says.

Conversely, the payers are driven to focus on costs above all else and cannot fairly or fully balance their concerns with consideration of the long-term benefit to the patient. "Stop eating!" is their message.

The sellers--doctors, hospitals, drug companies, and all the other suppliers--are caught between these conflicting signals. But still, they are the sellers, and so, in general, they will try to provide what the patient requests. Consequently, like the compulsive overeater, we as a society cannot seem to check our consumption.

The side effects of this fundamental economic dislocation are pervasive. Harvard's Michael Porter argues that competition in health care has become a zero-sum game in which, "the system participants divide value instead of increasing it." He describes how, instead of competing to increase value to consumers, health care payers and providers compete to avoid costs to themselves. So what we see is an endless cycle of cost shifting. Thus "gains for one participant come at the expense of others--and frequently with added administrative costs."³

It's obvious how such behavior powers the upward spiral of costs. It's also obvious that the root of it lies in the fracture that separates patient from payer.

When I say that another key pathology in our system is like an autoimmune disorder, I'm thinking of the impact of various kinds of government involvement.

The immune system's function is to protect the body, mainly by detecting and neutralizing harmful intruders like viruses and bacteria. But sometimes, the immune system runs out of control and begins attacking the body itself--that's the essence of an "autoimmune" disorder.

Most government regulations in our economic system are designed to protect citizens from potentially harmful practices. But in the case of health care, massive over-regulation--while surely intended to protect us--has instead created a great deal of economic "friction"--tremendous waste and inefficiency--that is crippling the system as a whole.

Recently, one group of scholars attempted to compute the total economic impact of all the regulatory complexity in our system. Subtracting total benefits from total costs, they concluded that regulation in our current system imposes excess costs of at least \$169 billion per year.⁴

In health care, sometimes even the best-intentioned acts of government intervention can have unintended and undesirable consequences.

³ See Porter and Teisberg (2004).

⁴ See Conover (2004).

The split between patients and payers can be traced to a quirk of policy expediency during World War II, when the Roosevelt administration allowed employers to skirt temporary wage and price controls by offering health benefits to workers in lieu of higher wages.

What really locked this system in place, and greatly amplified the economic dislocation it causes, was the subsequent decision by the government to exempt these benefits from taxation.

All of us who receive our health care through our employers are dependent on this break, but it has pernicious consequences. In effect, it inflates our currency for buying health care insurance, and thus compounds the third-party payer problem in weakening the price signal in health care transactions. Consumers who enjoy this invisible subsidy are less sensitive to the true consequences of price and, therefore, so are suppliers. This is one of the keys to the perpetual rise in health costs.

And of course, it's a key to the problem of the uninsured. If you don't get health coverage through your employer, you don't get this significant discount. You have to pay full fare, and many simply can't afford that.

This is not to say that all of the wasteful "friction" in the system can be laid at the door of government. A significant part of it arises from the third systemic disorder, which I compare to a cognitive disorder. Our health care system seems to be plagued by a strange pattern of willful ignorance.

Many of the deadly medical errors and other quality problems that plague U.S. health care can be traced to a gap in the flow of necessary information. Too often, vital information is not available not because it doesn't exist but because we do not allow ourselves to see it, share it, and act upon it.

"Exhibit A" is the general failure to fully adopt and implement the advantages of modern information technology. Though it's starting to change, too many people in health care are still living in a world of paper charts and hand-scrawled prescriptions. We need a world in which our doctors have instant electronic access to our complete medical records.

And, for consumer-driven care to work, we need a world in which consumers can go online and get reliable information about price and performance for health care products and services.

Now, with this background, take another look at the president's proposals. You can see that these are not just a few random "good ideas." Each of them is intended to address one or more of these structural problems. Together, they constitute an action plan for comprehensive health care reform.

To take our last issue first, his proposal to jump-start a national health IT system is self-explanatory. Specifically, his new budget would allocate \$169 million to this effort, most of it dedicated to solving the key problem of "interoperability" that is, developing standards to allow private and public health information systems to talk to one another.

Second, the proposals to reform medical liability and health insurance laws would address two of the biggest sources of economic friction in our system. Medical torts now impose a net cost of about \$80 billion per year on the U.S. system. Some kind of rational reform is long overdue.

As for deregulating insurance markets, I'll defer to my colleagues here. But I can't see any virtue in having 52 separate markets defined by state governments. Some refer to the reform concept as "ERISA for all," meaning, in essence, let's let everyone have what large corporations have in this country: freedom from state regulation of health insurance. Let's all enjoy the efficiencies of a national market.

But the measures that have the greatest potential for creating true health care reform are those that would improve and expand the Health Savings Accounts that Congress authorized in the Medicare Modernization Act.

These HSAs are designed to be combined with high-deductible catastrophic insurance coverage, so that people first meet medical expenses and premiums from the HSA up to the deductible limit, after which the coverage kicks in. This structure can dramatically reduce the cost of the insurance coverage. But the real point of it is to put purchasing power back into the hands of the consumer.

In order to instill a sense of personal ownership and to break the endless cycle of expanding costs, we need to heal the economic fracture at the heart of our present system. That will never happen as long as people continue to think of health care as "free," or as something paid for by someone else.

Finally, the proposal for a refundable tax credit really could shrink the ranks of the uninsured. The credit would be targeted to help low-income Americans buy an HSA-compatible high-deductible health plan.

Now, I don't want to suggest that these proposals can't be improved upon or that they will solve every single problem in U.S. health care.

For my part, I'd like to see HSAs expanded to make them even more appealing--for example, by permitting employees to convert current Flexible Spending Accounts into HSAs. And I'd like to see these new plans focus on what works best for patients. For example, I believe they should be structured to encourage preventive care.

I like the idea of offering tax credits to help low-income workers buy coverage. But ultimately, it would make the most sense to extend this credit to everyone, provided it is used to purchase some form of health coverage. This would be a much more equitable alternative to the current tax exclusion for employer-based benefits.

And there are some other needs that aren't addressed in the president's proposals.

Still, this said, it's important to acknowledge that behind these new initiatives is a remarkable vision for health care reform in this country--the first in my lifetime to try to harness the power of markets rather than government mandates.

Make no mistake; maintaining the status quo is not an option. The current system in the U.S. must undergo dramatic change as the Baby Boomers retire and overwhelm the current entitlements structure. The alternative to the free-market approach is some version of the government-centered approach used in Canada and Europe. That concept still has plenty of powerful supporters in this country, and they believe their "turn at bat" is coming in the next election cycle.

I have lived and worked under several of these centralized systems, and I believe they all have serious flaws.

The reforms the administration is proposing will not be easy for my industry to adapt to. But I'd much rather take my chances in a true, transparent, free market system ruled by consumer choice than in a command-and-control system, driven by the winds of politics.

I have to believe that most people who have seen the incredible benefits that a market economy has built in this nation, the miracle that is America, will make the same choice.

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