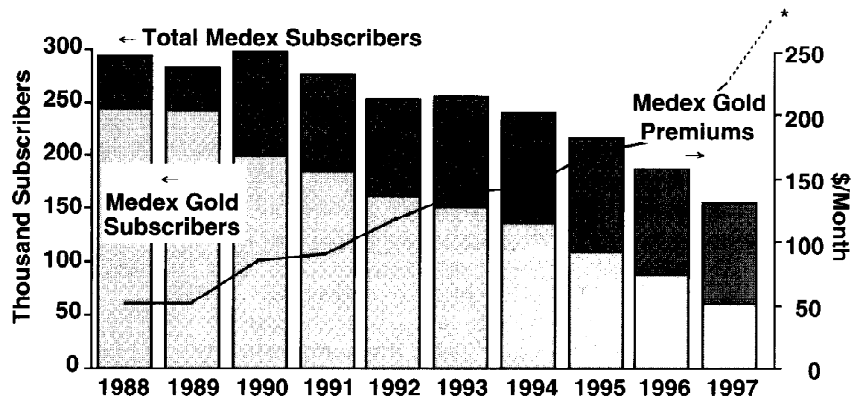


A Market Failure: Health Insurance

The #2 "Drinking Liberally" issue for those voting on 6/5/07, after Global Warming, was Universal Health Insurance. This is a prime example of how "free market" failures are behind our major social problems.

That's because these problems are a result of conditions that are dynamically complex (see "What is Systems Thinking?" on my website). As John Sterman writes in his *Business Dynamics, Systems Thinking and Modeling for a Complex World* (2000) textbook, "... imperfections create feedbacks that sometimes overwhelm the negative loops normally balancing supply and demand, leading to inefficiency or even to complete failure of the market."

From his text, p.177, on Medex medigap insurance for the elderly, Blue Cross Blue/Shield of Massachusetts: premiums up, subscribers down.



Source: Boston Globe, 20 January 1998, A1.

For health insurance, the market failure is *primarily* due to what's known as "adverse selection." Adverse selection occurs in situations for which there is "asymmetric information." In this case, it's that you know more about the status of your health than do the insurance companies.

Over 46 million persons in the U.S. were without health insurance in 2005 and the number is increasing steadily. Over 11 percent of the children, over 8 million, were not covered. The U.S. "system" is failing.

Health Care Dynamics

<http://www.exponentialimprovement.com/cms/healthinsurtabor.shtml>

The death spiral of our current, fundamentally free-market-based, health care system is due to our focus on the individual, rather than the whole. Here are the reasons:

Adverse selection: Healthy people take the risk that they can do without

insurance, leaving the less healthy in the system. Premiums rise and again the most healthy, as well as many who just can't afford it, drop out. The again results in rising premiums and increasing dropouts of the healthiest. It's a reinforcing feedback causing a death spiral.

Adverse selection causes havoc in a market economy because of *asymmetric information*, in this case because the buyers know their health situation better than the sellers. The understanding of this phenomenon is important and it led to a Nobel Prize award in 2001.

Dropouts get sick: Some take a risk, betting they won't get sick, and don't get insured. Others simply can't afford it. Some lose the bet and get sick. The logical outcome in a pure free market system would be to just let them sicken and die. Thankfully, for the most part, our society is unwilling to do so. They often get some kind of government-funded care with many going to emergency rooms for treatment. The costs, some excessive, are passed on to the public in higher taxes, and to businesses in higher premiums, as much as 15 percent higher. The higher taxes and higher premiums to businesses cause even more people to drop, or be dropped from, coverage. This reinforces the death spiral.

Loss of positive externalities: We don't take advantage of them. For example, when you spend money on your health care, it benefits me. First, because I'm less likely to get sick, and, second, because if we work together, I'm going to be more efficient when you're in good health. Therefore, the result is higher premiums, and less income to pay them, when everyone isn't covered.

Short-term orientation: Though it's more efficient to prevent health problems than to treat them, all companies, including HMOs, find it difficult to spend now for lower costs in the future. It's faster and easier to deny care, to save now by not spending on prevention. Those denied care often sue, which drives up costs. And, according to a 1999 Institute of Medicine report, "To err is human," two studies show that between 44,000 and 98,000 hospitalized Americans die each year due to medical mistakes. This costs lives and also results in lawsuits. So instead of driving costs down by prevention, our system now drives them up due to the higher costs of treating people after they get sick and legal expenses.

Unfortunately, there's a drive to cover up the root causes of the legal problems by taking the determination of lawsuit awards away from juries, who hear all the evidence, and impose one-size-fits-all caps on awards.

These problems are causing the death spiral of our health care system.

The market is a powerful mechanism. It works well to solve many, many problems. But **for some problems, only collective, government-based solutions will suffice. Individualistic, market-based solutions are doomed to fail.** Health care is but one example.