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Institute for Health Policy

The Power of Consumer Choice

Thoughts from the Conference: "The Transformation of Competition in Health Care"

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"Competition is not only the basis of protection to the consumer, but is the incentive to progress" — Herbert Hoover

For as long as there have been health economists, there has been a debate about the use of market competition to improve health care quality, costs, and access. One thing upon which everyone appears to agree is that Adam Smith's "invisible hand" — the hand that would shape markets to produce the best outcome for all — seems to be tied behind someone's invisible back when it comes to health care. But what economists can't agree on is *why?* Is health care fundamentally different from other products and services, and therefore not subject to the same rules of free markets? Or have we simply, erroneously, treated health care differently through a series of historical accidents and tax code foul-ups?

The health policy community has suffered no shortage of great minds willing to engage in this debate, but no compelling answers have emerged. And yet, despite a lack of answers, the red-white-and-blue flag of competition is once again being raised as the centerpiece of national health policy, this time in the form of health savings accounts and other strategies for giving health care consumers more "skin in the game." These strategies seek to improve the demand side of the market as a means of motivating performance on the supply side. The thinking is that if we could only transform "patients" into "consumers," then the invisible hand would be free to do its work — that consumerism would mean a return to *real* competition among providers, who would no longer be held captive by the restrictions that managed care placed on consumers' choices. But, can a consumerist paradigm really work in health care as it does in other industries, in which increased consumer demand leads to improved supply of services and information, which in turn leads to more marketplace competition and better, cheaper products?

In December, 2005, the Kaiser Permanente Institute for Health Policy, *Health Affairs*, and the Center for Studying Health System Change convened a group of experts to discuss the notion of consumerism as a

driving force in health care competition. The goal of the conference, entitled "The Transformation of Competition in Health Care," was not to debate *whether* consumerism can work but to discuss *what it would take* to harness the power of health care consumers more effectively, and, ultimately, whether it is worth it.[1] Where will we find the needed market supports for consumers (e.g., better information and meaningful choices)? Can we expect these supports to spring spontaneously from the market as consumers become more activated, or will they need to be created? What we learned is that even the most free-market oriented economists and experts don't believe that the plain-vanilla, invisible hand paradigm of competition fits health care very well.

This issue brief encapsulates some of the major themes and ideas that emerged from the December conference. It is both a summary of the meeting and the authors' thoughts, inspired by the expert speakers and audience-members alike.

Shift in Markets: from Delegation to Individual Management?

The conference's lead-off speaker, Paul Ginsburg of the Center for Studying Health System Change, set the parameters for the discussion by asking participants to respond to the following questions:

1) How can health care markets be best organized to leverage the role of the consumer?
2) What are the most appropriate entities to act as consumers' agents?[2]
3) How can information be better used to support competition?
4) What is the political and policy climate for shaping competition?

While each of the framing questions was addressed, it was the first — the question of improved market organization to support consumerism as the engine of competition — that dominated the discussion. How the health care universe is organized and presented to the consumer — by and/or through solo practitioners, medical groups, integrated systems, focused factories, insurers, employers, "exchanges," or various other entities — determines what support consumers require in terms of information and "agency."

Over the years, various agents have attempted to address cost and quality problems by organizing health care markets for consumers. These agents have included providers themselves but, more prominently, employers and health plans (for privately insured patients) and government (for public program enrollees). Because none of these agents has been entirely successful, some analysts have suggested that individuals are their own best agents in the health care market and should be given back more responsibility

What is a Consumer Agent?

An important theme of the conference was that consumers need "agents" to help them navigate health care markets. In this context, agents are entities and organizations that can support consumers by performing complex tasks on their behalf, for example:

- Negotiating prices with health care insurers and/or providers;
- Negotiating benefit designs with insurers;
- Structuring consumers' choices of insurers and/or providers so that they are manageable;
- Providing understandable comparative information on price and quality, thereby directing consumers to higher quality or more efficient insurers and/or providers;
- Making medical choices where patient preferences are not critical;
- Ensuring that providers meet basic levels of competence, and technologies and drugs meet basic levels of safety and effectiveness.

and power to impact cost and quality of care through the choices they make.[3]

Influential policymakers are also calling for a shift from a model in which the tax code encourages individuals to delegate to others the responsibility for managing the market on their behalf (a "delegation" model) to an individual management model. President Bush has called for an "ownership society" in America generally. In health care, the centerpiece of this concept is the health savings account. The White House notes that, "the U.S. health care system can provide the best care in the world, but rising costs and loss of control to government and health plan bureaucrats threaten to keep patients from getting state-of-the-art care."[4] Bill Thomas, Chairman of the House Ways and Means Committee, argues that "the fundamental problem of health care is the lack of consumer involvement" and that "[a]n informed consumer with the wherewithal in a marketplace can have a significant, positive impact on the cost of health care delivery."[5]

While there are few defenders of the status quo, some analysts believe that cost and quality issues must be addressed not by abandoning the notion of agency, but by attempting to improve the tools available to health plans, governments, and other "agents." These tools include financing and payment mechanisms that reward efficiency, as well as information for purchasers to choose high quality providers.

Two different schools of thought regarding the delegation and individual management models were framed in a kind of back-and-forth intellectual duel by Professors Alain Enthoven of Stanford University's Graduate School of Business and Regina Herzlinger of the Harvard Business School. The experts crossed conceptual swords over opposing visions of a managed competition market and a consumer-driven health care market, respectively. However, they did find middle ground supporting the need for more opportunities for consumers to make responsible choices.

Enthoven discussed the many barriers to competition that afflict the health insurance/delivery market. He believes that pro-active institutions are needed to make this market work, similar to the New York Stock Exchange (which has rules and active management). He calls such institutions "regional exchanges." Exchanges would bring together multiple regional employers, large and small, and possibly individuals, and multiple regional insurers, as occurs in a handful of public employee insurance exchanges in California, Washington, and Wisconsin. Exchanges would:

- Guarantee issue and market the insurance plans, run the periodic open enrollment process through employers (to the extent employers are still in the system), and provide side-by-side comparative information for consumers;
- Enforce quality-related information reporting requirements;
- Perform risk adjustment of premiums so that costs are spread equitably over the whole group and to create incentives for plans to enroll sick people, not to avoid them. As a part of this process, exchanges could create regional reinsurance pools for very high cost cases or conditions;
- Standardize the fine print in insurance contracts, enforce minimum coverage requirements, and standardize plan designs so that consumers can make comparisons at reasonable search costs and switch easily with confidence (These activities would counter market segmentation and inelastic demand and inhibit risk selection.);
- Present consumers with "responsible" choices by subsidizing the most efficient plan offered while allowing consumers to "buy-up" with their own money if they prefer a more expensive plan.

Against this vision of exchange-managed competition, Herzlinger portrayed a health care market resembling other consumer-driven industries, such as automobiles or computers, in which "consumers do the buying directly" without the aid of third party organizers. Such consumer-driven markets, she argued, are "characterized by ever-increasing reliability, safety, quality, and decreasing cost," in contrast to the health care market, which is a story of "rising prices, poor reliability and safety, uneven quality, and a lack of access to consumer information."

To achieve such a market, Herzlinger would set entrepreneurs free from regulatory restrictions to unleash a host of innovative, direct-to-consumer insurance products, including a wide variety of consumer-directed health plans

along with the more traditional HMO and PPO products. She looked to three types of insurance entrepreneurs to transform today's market, which she believes is characterized by little choice in products and a paucity of consumer-friendly information. What's needed, in her view, is a "Henry Ford" type of entrepreneur to produce higher quality, lower-cost health care services, such as "focused factories" on chronic conditions and high-cost surgeries; an "Alfred Sloan" type of entrepreneur that would create multiple insurance products with extensive consumer choice; and a "J.D. Power" type of entrepreneur that would act as an independent purveyor of reliable information on quality and cost but not as a prescriptive filter on consumer choice.[6] She argued that no single health care organization, no matter how large or integrated, can provide best care for all types of chronic conditions, and that in the new competitive model the big, consolidated provider organization will give way to an era of highly specialized organizations and consumer choice.

While these two visions of the health care marketplace appear on the surface as opposites, it is notable that they in fact share a powerful common concern for the importance of broad choice in products and the ultimate role of the consumer in making a "responsible" choice. Both visions, in fact, look to consumer choice as the driver of improved quality and efficiency, and both experts agree on the need for risk adjustment and mandatory disclosure of price and outcomes information. The question, as James Robinson of U.C. Berkeley observed, is what kind of supports (or agents) do consumers need to make a responsible choice, and should those choices be in any way limited by the party acting as consumer agent? On those questions, the Enthoven and Herzlinger visions diverge — a reflection of the fundamental differences in their starting points. Whether or not these two conceptual models share anything more than a common commitment to the value of consumer choice is a question worth exploring, and to their credit Enthoven and Herzlinger have continued to do so through development of a yet-to-be-published "détente" paper on consumerism.[7]

Agency and Consumer Information: The "Oprah Winfrey Factor"

If views about market organization in health care gravitate to a few basic conceptual approaches, it is not surprising that ideas about the need for consumer decision support (both passive and active) follow in similar directions. While there is virtual unanimity on the need for greater and more "consumer-friendly" health care information sharing, there are multiple points of view regarding who is best positioned and most trusted to process and deliver such information to the consumer.

There are also many views on what additional roles (if any) such agents might play in promoting a genuinely consumer-driven system, such as negotiating provider contracts, performing risk adjustment, or even making medical choices where personal preferences are not significant. Those who lean in the direction of a more heavily managed market naturally favor more activist, directive agency roles. As one participant put it, "Most consumers and businesses want affordable, quality care, but they don't want to have to manage it. They don't want to deal with the tyranny of choice." What's more, said Robert Krughoff, publisher of the Consumers' Checkbook Magazine and an expert on consumers' use of quality and cost information, consumers are accustomed to letting various institutions, mainly health plans, play strong agency roles and are not inclined to take on those responsibilities themselves. "It would be silly to think that the role of the agent can ever be dramatically reduced [in health services]," he said.

Later in the discussion, representatives for three institutions that do or could perform the agency role on behalf of consumers presented the case for their respective organizational type — a large employer, a health plan, and a large multispecialty medical group. Each made a persuasive argument for their ability to perform such vital agency functions as measuring quality and rewarding it; providing information and other consumer decision-support tools, analyzing and publicizing outcomes data; promoting the use of evidence-based care guidelines, ensuring transparency

on cost and quality; promoting greater coordination of care, etc. Yet it is also clear that no player currently performing those roles has won the wholehearted trust of consumers necessary to the role.

As Dr. Robert Galvin of GE observed, "Consumers want and need a trusted authority — a kind of Oprah Winfrey for health care — and it's not likely to be an employer or a health plan or a provider organization," though each can and must perform important consumer support roles.

And what about the government? Most agreed there are a number of actions that various levels of government could take to promote a more consumer-centric health care market. These include mandating individual coverage, as Massachusetts has done, promoting and helping to fund the implementation of health information technology, supporting comparative effectiveness research on drugs and technology, facilitating development of a standard set of quality measures; and paying for quality, as the Centers for Medicare and Medicaid Services (CMS) has begun to do. As Tom Scully, former CMS administrator, put it, "The government's job is to drive change through setting voluntary standards with financial incentives and disincentives."

Conclusion: No More Either/Or

Conference wrap-up speaker Jon Christianson of the University of Minnesota summed up the consensus of the participants on the question of consumer-driven competition as "no more either/or," meaning consumers should have choice at both the level of health plan selection and at the point of care. In addition, we should no longer be asking *whether* consumer choice can transform health care competition (because consumer choice is here, like it or not), but rather how to harness the power of consumerism to change the system for the better.

As noted earlier, the conference revealed that even the most free-market oriented economists and experts don't believe that the plain-vanilla, invisible hand paradigm of competition fits health care well. Instead, or in addition, what is needed is something akin to a shot in the arm for that invisible hand — in the form of a consumer "agent."[8] Happily, the roster of potential players to assume the agency role is quite lengthy.

While viewing health care competition in relation to *delegation* versus individual management of choices helps re-frame this debate, it has by no means resolved the issue. In a sense, health care markets today are playing out a natural experiment to test these two hypotheses about what will work best — an experiment that, because of its duality, sends confusing signals to the delivery system in local markets. In some cases, we see health care exchanges and activated purchasers and carriers creating high-value networks that are paid based on global measures of performance. We also witness some purchasers, assisted by various sources of support, turning decision-making over to employees as they adopt "consumer directed health plans" for all. The problem, however, is that while both experiments are taking place, both are somewhat hamstrung — the delegation model by employers' increasing reluctance to wade into health care decision-making, and the individual model by a dearth of truly useful consumer information. Only time will tell whether either model will ever get a fair hearing. We believe that each should.

Note: *the views expressed in this paper are solely those of the authors, not those of the conference speakers or quoted experts.*

Endnotes

1 See www.kpihp.org/events/1205_competition.html for additional information about the conference, including agenda, speaker materials, and webcast.

2 See sidebar for a discussion of "agents."

3 See, for example: R.E. Herzlinger, *Consumer-Driven Health Care: Implications for Providers, Payers, and Policymakers* (San Francisco: Jossey-Bass, 2004); R.E. Herzlinger, "Let's put consumers in charge of health care," *Harvard Business Review*, 2002 July, V80 no.7:44-50, 52-5, 123; J. Goodman, "Health Savings Accounts will Revolutionize American Health Care," *Brief Analysis* no. 464, January 15, 2004, National Center for Policy Analysis, www.ncpa.org/pub/ba/ba464/, (accessed 7/26/06).

4 *"Fact Sheet: America's Ownership Society: Expanding Opportunities,"* The White House, Office of the Press Secretary, August 9, 2004, www.whitehouse.gov/news/releases/2004/08/20040809-9.html (accessed 7/26/06).

5 Speech to National Small Business Association, June 8, 2005.

6 By introducing many manufacturing innovations, Henry Ford reduced the cost of automobiles by 50 percent in eight years while vastly improving quality; but he was also known to have said consumers could have any color car they wanted, as long as it was black. In contrast, Alfred Sloan embraced the consumer-choice principle. As the former president of General Motors, he established a pricing structure in which Chevrolet, Pontiac, Oldsmobile, Buick, and Cadillac did not compete with each other, and a buyer could be kept in the GM "family" as his buying power and preferences changed. Finally, J.D. Power and Associates is well known in the automobile industry, not for selling products, but for providing independent consumer ratings.

7 Forthcoming, *Health Affairs*.

8 Perhaps a better analogy would be a "helping hand" for the invisible hand. However, that creative turn of phrase was employed by Rick Kronick in 1994 to refer to the concept of "managed competition" (see: R. Kronick, "A helping hand for the invisible hand," *Health Affairs*, V13, no.1 (Spring 1994):81-95), and what we would like to suggest here with the concept of "agency" is something broader than managed competition and inclusive of several other paradigms as well.

About IHP

The Kaiser Permanente Institute for Health Policy was established in 1999. Our purpose is to provide a focus and resources for Kaiser Permanente to better participate in shaping the nation's health policy agenda. We bring experts together to research and analyze health policy, with a goal of increasing understanding of policy issues and helping provide solutions. Working in collaboration with foundations, policy institutes, research programs, policymakers, and other organizations, the Institute seeks to develop unbiased information about health policy issues and alternatives.

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