WebMemo

Published by The Heritage Foundation

No. 1900
April 23, 2008

State Health Reform: Six Key Tests

Robert E. Moffit, Ph.D.

State legislators are increasingly focused on health care reform. Escalating health care costs, state deficits, rising numbers of uninsured, and federal inaction have forced them to take up the challenge of changing state law, restructuring flawed state health insurance markets, and overhauling existing health care financing and delivery. This often requires a special level of technical expertise and experience with health care policy.[1]

Many state legislators are committed to introducing free-market principles of consumer choice and competition into the health care system. Because the circumstances in each state are radically different, there is no neat nationally applicable formula for free-market reform.[2]

There is, however, one overarching policy goal that should unite legislators seeking to develop and implement conservative or free-market reform: The legislative changes would shift the locus of decision-making to *individuals and families*, and they—not insurers or the government or employers—should control the flow of health care dollars.

Criteria for Change. Reformers merit the approval and support of those who favor market-based reform to the degree that they accomplish that transfer of control to individuals and families. Serious reform would meet the following tests:

- *It is system-based, not product-based.* It is focused on changing the existing system, not merely promoting a specific insurance product or change in the delivery of medical services.
- *It makes individuals and families the key decision-makers in the system.* They control the dollars.
- *It creates continuous dependable coverage for individuals and families.* The coverage is designed to fit the changing conditions of modern American life.
- *It limits the role of government.* It expands private insurance options and reduces dependence on government health programs such as Medicaid and the State Children's Health Insurance Program (SCHIP).
- *It maximizes value to the consumer as a patient.* The value to the patient overrides the value to other players in the system.
- *It complies with existing federal law.* It does not, therefore, delay possible change.

The Federal Role. Federal inaction is in many ways a blessing in disguise. It would be folly for Washington, D.C., to force radical changes across the entire health care sector—which comprises roughly a sixth of the American economy—without experimenting and discerning what proposals work best in expanding coverage, controlling costs, and increasing patient freedom and satisfaction.

Congress could encourage this process by advancing legislation that would allow differing policy proposals to compete "head to head" in various states. Such contests would highlight successful

This paper, in its entirety, can be found at:
www.heritage.org/Research/HealthCare/wm1900.cfm

Produced by the Center for Health Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Heritage Foundation
LEADERSHIP FOR AMERICA

programs that could be adopted in other states as public approval increases. This could also break the health policy impasse at the national level and encourage action on specific reform measures that are successful and enjoy broad bipartisan support.[3] Advocates of free-market reform should welcome such a competition of ideas.

Six Tests for Reform. State officials have a large task ahead of them that is aggravated by the unfunded liabilities of their own state retiree health costs.[4] Competing approaches, sharply different in nature, scope, and objectives, currently dominate state reform proposals.

Many conservative and centrist legislators aim for private, insurance-based health reform that encourages competition, expands access to private coverage, and strengthens the market as a way to discipline health care costs.

Many liberal and leftist legislators are motivated by a belief that health care should be a public utility. They often embrace what they believe to be the superiority of government-run or single-payer health systems, centralized government power over purchasing, government benefit-setting, and price controls for insurance and medical services.

Every state regulates its own insurance industry and thus has its own unique health care infrastructure. Although one "standard" health reform proposal cannot meet every state's needs, state-based reform proposals can and should be evaluated on the basis of whether they would move a state's health care system toward patient-centered health care, which would maximize value to the patient.[5]

The six tests for meaningful reform are as follows:

1. The reform is system-based, not product-based, and is focused on expanding ownership of private insurance coverage. System-focused reforms look toward a restructuring of the financing and delivery of medical services, such as changing the delivery of existing government health care subsidies. Product-based reforms attempt to enact the proverbial "silver bullet" to control costs or improve quality. The temptation is to focus on designing specific products, such as new government programs, new managed-care arrangements, or health savings accounts for discrete subpopulations while leaving the flaws of the current system firmly in place.

The right approach is to pursue system-focused reforms and implement policies based on private insurance that would enable individuals and families to buy, own, and keep health insurance from job to job—without losing the tax advantages of employment-based coverage.[6] There is no free-market reform worthy of the name in which individuals are denied control over their own health care dollars, are denied a property right in the health insurance policies purchased with those dollars, or are directly penalized by the government's

1. In response to requests from many state officials over the past two years, Heritage analysts have greatly increased the amount of technical assistance and educational outreach to state policymakers and stakeholders on ways to expand health care coverage while maximizing health care value for individuals and families.
2. On this point, see Robert E. Moffit and Nina Owcharenko, "The Massachusetts Health Plan: Lessons for the States," Heritage Foundation *Backgrounder* No. 1953, July 18, 2006, at *www.heritage.org/research/healthcare/upload/bg_1953.pdf*.
3. For more on the prospects for such a federalist approach, see Henry J. Aaron and Stuart M. Butler, "How Federalism Could Spur Bipartisan Action on the Uninsured," *Health Affairs*, March 31, 2004, at *http://content.healthaffairs.org/cgi/reprint/hlthaff.w4.168v1.pdf*.
4. On this fiscal challenge, see Greg D'Angelo, "State and Local Governments Must Address Unfunded Health Care Liabilities," Heritage Foundation *WebMemo* No. 1808, February 11, 2008, at *www.heritage.org/research/healthcare/wm1808.cfm*.
5. Edmund F. Haislmaier, "Health Care Reform: Design Principles for a Patient-Centered, Consumer-Based Market," Heritage Foundation *Backgrounder* No. 2128, April 23, 2008.
6. For a discussion of how this can be done, see Robert E. Moffit, "The Rationale for a Statewide Health Insurance Exchange," Heritage Foundation *WebMemo* No. 1230, October 5, 2006, at *www.heritage.org/Research/Healthcare/wm1230.cfm*. See also Robert E. Moffit, Ph.D., "State-Based Health Reform: A Comparison of Health Insurance Exchanges and the Federal Employees Health Benefits Program," Heritage Foundation *WebMemo* No. 1515, June 20, 2007, at *www.heritage.org/research/healthcare/wm1515.cfm*.

The Heritage Foundation
LEADERSHIP FOR AMERICA

tax or regulatory regime for choosing the health plan they want.

2. As a result of reform, individuals and families are the key decision-makers. If state officials put *individuals and families* at the center of health care decisions, the results would be profound. Until individuals and families have meaningful choice in their health care coverage, most Americans will have little more control over their health care dollars than a dog taken to a veterinarian has.

Reform should not displace employers from the health care equation; it should change their role. Employers should become the facilitators of health insurance coverage for employees rather than the exclusive owners of their employees' health insurance policies.[7]

Employers and managed-care executives control most of the dollars in the current system. If the government were to control these health care dollars, it would decide what is funded and what is not.[8] Giving individuals and families control over their health care dollars would enable patients to choose care appropriate to their beliefs and needs, paid through an insurance company that they have personally chosen.[9] Owning one's own permanent, dependable, portable health insurance would give Americans the freedom to choose the health care they trust and help to provide the economic security they need.

3. The reform creates dependable, continuous coverage that fits the dynamics of modern American life. Americans know that the problem of health insurance is not simply getting access to coverage; it is also keeping that coverage, regardless of where one works or lives. Modern health care coverage should work with the major transitions in modern life and should eliminate the predictable threats to health care—the "health-care cliffs."

Every American should be free to meet life's challenges without its endangering their health coverage. Without putting their health care at risk, young adults should be able to head off to college or work without worrying that they are leaving their family's health plan. Workers of all ages should be able to pursue better opportunities, start new businesses, and retire before they are eligible for Medicare. Without putting their own health care at risk, parents should be able to stay home to take care of their children or their own elderly parents. Modern health care coverage would eliminate the existing chasm between public health care assistance and private insurance.

To achieve this goal, health care coverage must be portable: It must stick to the individual, not the job. Coverage must be owned and controlled by the person it covers. Two basic aspects of our employer-based health care system—tax treatment and sponsorship—must be addressed to allow the growth of a truly modern health care system. Favorable tax benefits associated with employer-based health insurance must be unshackled from employer selection, control, and ownership. Americans may access coverage through employers, but they also must be allowed to get coverage through a trusted agent or sponsor other than their employers.

4. The reform limits the role of government and avoids government-run health care. There is no market without the rule of law. The state govern-

7. For an extended discussion of this point, see Stuart M. Butler, "Evolving Beyond Traditional Employer-Sponsored Health Insurance," Hamilton Project, May 2007, at *www.brookings.edu/es/hamilton/200705butler.pdf*.
8. For a discussion of the costs and consequences of government rationing of care, see Kevin C. Fleming, M.D., "High-Priced Pain: What to Expect from a Single-Payer Health Care System," Heritage Foundation *Backgrounder* No. 1973, September 22, 2006, at *www.heritage.org/research/healthcare/bg1973.cfm*.
9. With the inevitability of sensitive decisions over end-of-life care and beginning-of-life care, this will become an increasingly serious concern for ordinary Americans. For a broader discussion of this issue, see Robert E. Moffit, Jennifer Marshall, and Grace V. Smith, "Patients' Freedom of Conscience: The Case for Values-Driven Health Plans," Heritage Foundation *Backgrounder* No. 1933, May 15, 2006, at *www.heritage.org/Research/healthcare/bg1933.cfm*. See also Connie Marshner, "Health Insurance Reform: What Families Should Know," Heritage Foundation *WebMemo* No. 1739, December 13, 2007, at *www.heritage.org/research/healthcare/wm1739.cfm*, and Connie Marshner, "The Health Insurance Exchange: Enabling Freedom of Conscience in Health Care," Heritage Foundation *WebMemo* No. 1377, March 1, 2007, at *www.heritage.org/research/healthcare/upload/wm_1377.pdf*.

ment's role, therefore, is limited to making and enforcing the common set of rules that allow free-market forces to operate on a level playing field. This is especially true for the rules that govern the health insurance markets. Though the government should play the role of watchdog—enforcing rules against fraud, for example—it should not be in the business of picking winners and losers.

The government should work to reduce dependence on government programs such as Medicaid and SCHIP.[10] This can best be accomplished by expanding private health insurance options, especially for low-income individuals and families, and mainstreaming them into the private health insurance market just as their fellow citizens are.[11]

5. The reform maximizes value to the patient. Real patient-centered, system-focused reform must demand and reward both improvements in health care benefits and reductions in costs. Better care at lower cost results in value for the patient. Value for the patient is secured by personal choice and competition among health plans and providers.[12] Competition controls costs and drives innovation and productivity in the health care system. It is essential for state reformers to keep in mind the objective of their reform efforts: value *to the patient*, not to the "health care system," managed-care executives, health insurance executives, or government program officers. State health reform that falls short of being patient-focused falls short as meaningful reform.

6. The reform complies with existing federal law. Health care is governed by a complex and often overlapping set of federal and state laws. State officials need to be mindful of the federal statutes that govern the health insurance markets. Chief among these are the Employee Retirement Income Security Act of 1974 (ERISA), which governs the provision of coverage for self-insured firms; the Consolidated Omnibus Reconciliation Act of 1985 (COBRA), which establishes rules for maintaining group coverage during specified periods for employees who leave employment; the Health Insurance Portability and Accountability Act of 1996 (HIPAA), which establishes rules for a limited guaranteed-issue of coverage of health insurance; and the Internal Revenue Code, which provides for a generous tax exclusion on the value of health benefits provided through employment-sponsored coverage. Federal tax law has a tremendous effect on health insurance markets, disfavoring those who do not or cannot get health insurance through the place of work.

Federal laws set parameters for innovative state reform. In crafting state health reform legislation, state officials must be creative if they want to accomplish significant change, but they must also be sure that their proposals comply with existing federal laws and regulations. Otherwise, they risk a derailment, a delay, or judicial obstruction of their efforts. For example, state officials cannot redefine individual insurance as group insurance for the purposes of circumventing the existing provisions of federal laws that govern group health insurance.

Conclusion. Most working-age families who have health insurance receive their coverage through their workplace as group coverage. Group coverage is governed by federal and state law. Though state officials must navigate federal laws, they can nonetheless make significant headway in changing the dynamics of the system by changing the health insurance regulations that are within their jurisdiction.

10. On this point, see Nina Owcharenko, "The Future of SCHIP: Family Freedom or Government Control?" Heritage Foundation *WebMemo* No. 1464, May 21, 2007, at *www.heritage.org/Research/healthcare/wm1464.cfm*. See also Greg D'Angelo, Michelle Bucci, and Marcus Newland, "Expanding SCHIP Will Challenge State Finances: A State by State Analysis," Heritage Foundation *WebMemo* No. 1586, August 14, 2007, at *www.heritage.org/research/HealthCare/wm1586.cfm.*
11. Nina Owcharenko, "Health Insurance for Uninsured Children: Doing Health Care Right," Heritage Foundation *WebMemo* No. 997, March 5, 2007, at *www.heritage.org/Research/HealthCare/hl997.cfm*. See also Nina Owcharenko, "Reforming SCHIP: Using Premium Assistance to Expand Coverage," Heritage Foundation *WebMemo* No. 1466, May 22, 2007, at *www.heritage.org/Research/HealthCare/wm1466.cfm.*
12. For an elaboration of this theme, see Haislmaier, "Health Care Reform: Design Principles for a Patient-Centered, Consumer-Based Market."

The Heritage Foundation LEADERSHIP FOR AMERICA

Free-market reform would transfer control of health care dollars to individuals and families and enable them to be the key decision-makers in the system. This reform would be system-focused. It would not promote specific products, goods, services, or "silver bullets." It would improve the health insurance market and allow continuous coverage for individuals and families throughout changes in their lives. Real reform would limit the role and the power of government and expand private health care options and opportunities. Above all, it would maximize value to individuals and families as patients.

State health reform is a challenge. But with political will and imagination, it can be done.

—Robert E. Moffit, Ph.D., is Director of the Center for Health Policy Studies at The Heritage Foundation.