CAPTIVE CONSUMERS IN OLIGOPOLIES DO NOT MAKE EFFECTIVE MARKETS

In a post citing liberally from a Matt Yglesias post naming me, Ezra takes on the argument that the health care bill, as currently conceived by President Lieberman, would be a bailout of the insurance industry.

> There's an argument on the left that the health-care bill represents a "bailout" to the insurance companies. Matt Yglesias puts this in the proper context:
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> > I've seen Marcy Wheeler characterize the plan as an "industry bailout." And, indeed, if I were a small government conservative one political tactic I would employ would be to start characterizing all initiatives involving government spending as a "bailout." You could say that [the stimulus]'s provisions funding K-12 education are a "bailout for teacher's unions." You could call [cap and trade] a "bailout for windmill makers." And you can call the health care bill an "insurance company bailout." But the mechanism by which insurers can get extra money under reform is that … more people get health insurance at a price they can afford.

For the record, I'm not positive I'm the one who did say that, but I'm not opposed to the invocation of my name in that context. I do,

however, find Matt's insinuation that I'm making the same kind of cynical argument conservatives do disingenuous at best. Particularly coming from a guy who claims that requiring middle class families to pay almost 10% of their income in premiums alone—more than 3 times as much as some experts say is affordable—is "a price they can afford."

Ezra, for his part, argues (again) that profit is not in and of itself a bad thing.

> To put this a bit more sharply, if I could construct a system in which insurers spent 90 percent of every premium dollar on medical care, never discriminated against another sick applicant, began exerting real pressure for providers to bring down costs, vastly simplified their billing systems, made it easier to compare plans and access consumer ratings, and generally worked more like companies in a competitive market rather than companies in a non-functional market, I would take that deal. And if you told me that the price of that deal was that insurers would move from being the 86th most profitable industry to being the 53rd most profitable industry, I would *still* take that deal.

Now, I've got a few nits. Ezra may not have seen the CBO directive that Jon Walker pointed to the other day, which suggests Harry Reid will be unable to insist on a 90% Medical Loss Ratio, the provision that would have forced insurers to spend 90% of premium dollars on care. And there are reasons to doubt that all the measures pressuring providers to bring down costs incent the right behaviors; while some are much-needed reforms, some may actually lead to more spending. But those nitpicks aside, Ezra rightly points out the aspects of this reform that a real improvements over what we've got now.

That said, Ezra's further examples (and

Yglesias') just prove the point those of us opposed to the bill in current form have been making, because they show the importance of functioning markets.

> The profit motive is not, in and of itself, a bad thing. The Apple computer I'm typing on, the Netflix movie I wish I were watching, the pork buns I wish i were eating — it all comes from profit. But Apple isn't allowed to have slaves build its computers, Netflix can't destroy the incentive to make films by pirating all of its DVDs, and Momofuku can't let rats infest its kitchen because exterminators are expensive.

First, let me deal with Matt's analogies. Some stimulus money goes to schools. That money is either appropriated at the state level through regular somewhat democratic appropriation processes (in which case it's a bailout for states, and the teacher's unions will be put in position of negotiating for fewer job cuts or wage decreases). Or it will be awarded to school construction contractors in localized markets that are both competitive and (because of transparency attached to the stimulus) very transparent.

Cap and trade has, in fact, been called a bailout—but of Wall Street, not wind turbine manufacturers, because it'll just create another big derivatives market. But for companies trying to reduce their greenhouse gas emissions to meet caps, yes, they may choose to buy wind turbines. Or they may choose any number of other ways to generate power releasing fewer greenhouse gases. The point is, though, there are many choices, and some, but not all of those choices, are markets in which there is real competition (and utilities are big enough they've got some power to influence these markets).

Now onto Ezra's analogies. I'm most intrigued by his Momofuku parallel, because it does point to one aspect of health care reform—the regulations

requiring insurers reveal a lot more information about their businesses, which hopefully will make it easier to pressure health care providers to improve their practices. But the analogy fails on a key point: consumers' source of pressure on Momofuku not to let rats take over its kitchen is twofold. We trust health inspectors will find the rats and issue a report making the rats public. And, very importantly, Momofuku has to compete with hundreds of other restaurants, and any hint that it's got a rat problem would make it competitively disadvantaged compared to these other hundred restaurants. Unlike Momofuku, Blue Cross in most markets has only a few other competitors. So a better analogy than Momofuku is probably school lunch programs, which are regulated by the USDA, but which aren't exposed to real competition. And, as it turns out, school lunches don't match the quality of meats offered at fast food restaurants which are exposed to competition.

> *In the past three years, the government has provided the nation's schools with millions of pounds of beef and chicken that wouldn't meet the quality or safety standards of many fast-food restaurants, from Jack in the Box and other burger places to chicken chains such as KFC, a USA TODAY investigation found.*
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> The U.S. Department of Agriculture says the meat it buys for the National School Lunch Program "meets or exceeds standards in commercial products."
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> That isn't always the case. McDonald's, Burger King and Costco, for instance, are far more rigorous in checking for bacteria and dangerous pathogens. They test the ground beef they buy five to 10

> times more often than the USDA tests beef made for schools during a typical production day.

That’s not rats, but it is a significant issue affecting quality. Increased transparency is not sufficient to force larger bureaucracies to improve quality. It’s an important element, but it’s not enough.

Then there’s Netflix. Now, I would describe Netflix’s service not to be making movies, but distributing them for home viewing. Netflix’s genius in devising a completely different way to deliver that service has now given it the market force to set certain market services. Maybe, if we’re lucky, someone will think of a totally innovative way to deliver health care and find a way to break into the concentrated market.

Finally, there’s Apple. Perhaps for obvious reasons, Ezra doesn’t consider the area where Apple’s shared monopoly—the iPhone—has made it a real target of customer dissatisfaction of late (though with the advent of Android, Apple will probably now become much more responsive to consumers). But his claim that Apple isn’t allowed to have slaves build its computers? While 80-hour work weeks are not quite slavery, the young women building keyboards for a bunch of other computer companies would have a few things to say about how profit incents some loathsome employer practices. NGOs have long sought to bring consumer pressure to bear on manufacturers of all sorts to make sure these kinds of working conditions don’t occur—but they do occur, and the profit motive is one of the things driving that.

I went through all of these not to contest the claim that there’s no inherent problem with profit (though when I used to consult for the pharmaceutical industry, they gleefully manipulated the regulatory process to push drugs they knew were less effective than other drugs in the name of making profits, and those drugs remain best-sellers). Rather, it’s that if

you're relying on profit as a motivator to produce lower prices or higher quality, there must be a real market. And that lack of that is the source of why this is different from stimulus or cap and trade or much other government spending. (It is similar in some ways to the defense industry, which is an important analogy since a number of our defense contractors are ungovernable and since costs are so high there, too. But there, at least, the government uses its own market power to protect state's interest.)

Which brings us to the end of Ezra's piece.

> Health insurance suffers from market failure in part because it suffers from regulation failure. We're adding the regulations now and we'll see, in 10 years, whether people hate insurers somewhat less, or whether they've embraced the nonprofit model, or whether they're clamoring for public insurance. Either way, putting insurers into a structured market where they'll have to compete against one another and users will rate them should make things a lot better. Public insurance might be the best way forward, but an insurance market that works for consumers is progress nevertheless.

He rightly admits that there is a market failure right now, but suggests that regulation will "in part" fix that.

And while I agree that the transparency measures in this bill give consumers one tool with which to force insurers to compete, the bill, as President Lieberman has dictated it must be, fails to use this opportunity to inject real choice into markets that are currently failures.

More importantly, the health care bill will make this far worse by depriving consumers of a key form of choice they currently exercise in huge numbers: the choice (painful as it often is) not

to carry insurance.

Our society long ago decided that profit could, in situations in which there was a real market, motivate corporations to provide society with something of value. And so, in cases where there was a functional market, society would be willing to pay a profit in exchange for the efficiencies that system offered. But even Adam Smith recognized that markets don't function with monopolies. And this bill exacerbates the problem of concentration by depriving consumers of one of the last choices they have—not to participate. Right now, insurance companies lose out on consumers who have decided their products are too expensive for what consumers get in return. The current bill requires consumers—a significant chunk of them facing precisely the same prices that today led them to choose to go without insurance—to enter a market with no real competition, one that, therefore, would not be required to pass on the profits resultant from a mandate to consumers.

I understand the logic for a mandate. But right now, there is little disagreement that concentration in the industry means consumers don't have the kind of power that our society uses as the very justification for profit. More importantly, by making markets less competitive by forcing everyone to participate, no matter the cost, you cede one of the only tools the government has (aside from effective regulation with legal consequences, which this bill doesn't have) to ensure that the health industry passes on the benefits that a mandate is claimed to produce.

So whether or not I'm the person who said this was an insurance industry bailout, I do believe this. The government is about to make insurance markets less competitive in a significant way, even while designing a system that depends on that very competition to produce the benefits it promises. A mandate makes sense—if insurance is affordable, if there are real choices in the market, and if the government has some means to

get insurance companies to share the benefits of that mandate. Right now, aside from the poorest consumers, who get subsidies large enough to make this affordable, none of that is true.

Right now, millions of consumers are exercising one of the only market choices they have in the current market—to tell insurance companies their products are too expensive, given the benefit consumers get in return. The government is about to tell many of them they can no longer exercise this market choice, yet it is doing far too little to change the other part of the equation, making the insurance affordable (in some ways it provides more value, but with 60% actuary plans acceptable, not all that much). That’s one of the key problems with the mandate: it violates the entire premise behind our society’s support of profit, and given our market structure, does not provide enough choice in the system to make the market work.