



The Health Care Blog

Everything you always wanted to know about the Health Care system. But were afraid to ask.

December 17, 2010

Goodman's Law



By JOHN C. GOODMAN

The other day I ran across five items of interest:

1. A [news article](#) about Medicare paying \$800 to rent a wheelchair that could have been purchased outright for \$350;
2. An article in *The Atlantic* arguing that the United States spends more on renal dialysis and gets worse results than other countries because of the nonsensical way we pay for dialysis;
3. A [Uwe Reinhardt explanation](#) of how Medicare pays hospitals ([via an approving pointer from Austin Frakt](#)) along with Uwe's defense of the system; but nonetheless linking to
4. A Reinhardt *Health Affairs* interview with former CMS director [Tom Scully](#) who opines that "Medicare is a dumb payer;" and
5. A [Reinhardt explanation](#) of how Medicare pays doctors (7,000 physician tasks, each with a price that varies for every city, town and hamlet in the land), along with a challenge to readers to come up with a better way.

Okay. I accept the challenge.

I sometimes wonder if health economists actually understand how other markets work. Let's try a thought experiment. Suppose you ran a business that purchased lots of wheelchairs and you had the misfortune of paying the way Medicare pays. What do you think would happen?

The minute your presence in the market was generally known — probably before the first wheelchair was even delivered — you would be visited by a rival vendor offering to meet your needs for, say, two-thirds of what you were paying. Then another rival would offer to top that — say, cutting your costs in half... and before long the cost of the wheelchair to you would be a fraction of what it started out to be. This is how normal, sensible people function in typical markets, day in and day out.

[Parenthetically, I meet people every day who could save Medicare tens of thousands of dollars, but they can't get the bureaucrats at CMS to return their phone calls because (like the TSA agents who search for bombs while ignoring passengers) the system is not guided by anyone with a modicum of commonsense.]

I'll skip over the dialysis case because we have previously pointed out that that particular payment system is [dumb](#), [dumb](#) and [dumber](#) and the principles are pretty much the same.

That will let us jump to the really interesting question: Is it possible for Medicare to purchase wheelchairs (and other health care) the way a rational person (spending his own money to meet his own needs) or a for-profit enterprise (spending its own money to meet its own needs) would do?

[Sorry for all of those qualifications, but in health care people rarely are spending their own money to meet their own needs — which is the source of most of our problems.]

The answer is: We could get huge improvement if Medicare followed the scenario I outlined above, including these commonsense steps:

1. Wheelchair vendors must be able to approach Medicare with offers to be paid in a different way, provided that the cost to the government is reduced and quality of care is maintained or improved.
2. Medicare does not set preconditions on what it will or won't do, but leaves the private sector completely free to innovate and find ways to lower cost and raise quality.
3. Medicare enters contracts as quickly as the private sector does — without long delays and inordinate paperwork.
4. Medicare devotes some of the savings it expects to realize to monitoring contracts and assuring promised performance and ending contracts or renegotiating if the terms are not abided by.
5. Medicare accepts upfront that not every contract will work out as expected and some decisions will retrospectively be seen to be wrong, because that is part of normal business experience.

Alert readers will notice that I have proposed this strategy before — in *The Wall Street Journal*, in the study *A Framework for Medicare Reform* and in many [other places](#). I even showed how

such as approach could [radically transform diabetic care](#), for example. Alas. It all fell on deaf ears. Alert readers will also notice that this approach is the exact opposite of the approach taken by the Obama administration, and before that by Bush, Clinton, and Bush. Instead of letting wheelchair vendors propose new ways of producing, renting and selling wheelchairs, the inside-the-Beltway mentality wants Washington to make all these decisions.

Any "reform" following the inside-the-Beltway approach will only substitute a new dumb payment system for an old one. Okay, maybe the new one will be a little bit smarter, but the bottom line will be the same. All the vendors will analyze the new payment formulas and set out to maximize against them.

Can you imagine the CEO of a private company reading in the newspaper that he is renting something for \$800 for 13 months that could have been purchased outright for \$350 and doing nothing about it because his company is committed to a payment formula that allows only renting and not buying? Of course not!

Here is Goodman's Law for Efficient Purchasing:

There is no such thing as a smart formula.

John C. Goodman is president and CEO of the National Center for Policy Analysis. He is also the Kellye Wright Fellow in health care. The mission of the Wright Fellowship is to promote a more patient-centered, consumer-driven health care system. Dr. Goodman's [Health Policy Blog](#) is considered among the top conservative health care blogs on the internet where pro-free enterprise, private sector solutions to health care problems are discussed by top health policy experts from all sides of the political spectrum.