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Perspective

Consumer-Driven Price Transparency

Making Health Care Prices Transparent Through the Free Market

by Mary Katherine Stout, director of the Center for Health Care Policy Studies

Price transparency has become the buzzword in health policy circles as the move toward consumer-driven health care takes hold. The idea of "consumerism" in health care—encouraging patients to shop for health care with the same eye toward value, price, and quality that they bring to other purchases—rests on individuals having access to the information to make these decisions.

Unfortunately, as people begin to embrace the notion of consumerism in health care, they struggle to find the clear information on price needed to make these decisions. This move toward greater consumerism in health care is a dramatic shift in the way Americans have thought about health care and health insurance, which has been dominated by government regulation and third-party payment, with little individual involvement. As a result, interest in health care prices has only recently gained real attention as prices skyrocket and individuals are bearing more of the cost of their care.

One consequence of the prevailing employer-sponsored health insurance system and the emphasis on third-party payment (where someone other than the individual patient pays the bill) has been the blurred identity of the real consumer. Although the patient may be the ultimate recipient of medical services, they have been largely shielded from the cost and control of their care. Instead, employers act as consumers in bringing business to insurance companies, while health care providers receive most of their payment from insurance companies or the government—again, acting as consumers. All of this has largely escaped the notice of the patient who has had little incentive or opportunity to shop for health care based on price and quality. As one would expect, the existing health care market has developed around this

Key Considerations

- Health care prices are complex and hidden from view because of the emphasis on third-party payment and the unintended consequences of public policy and government programs.
- Although polls show people overwhelmingly agree that they have the right to know the price of their care, there may not yet be a critical mass of individuals demanding this information.
- The growth of consumer-driven health care has made price more important to individuals and will continue to do so in the future.
- Consumer-patient demand for prices through the free market will deliver the most meaningful information to individuals, spurring real competition in health care.
- State and federal lawmakers interested in using legislation to compel price transparency should focus on making pricing information available to individuals through a written estimate of charges upon request.

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structure, no matter how inefficient. Consumer-driven health care, however, could begin to change all that.

"Consumer-driven health care" typically centers on patient-directed health accounts, like Health Savings Accounts, that put the purchasing and decision making power with the individual consumer-patient. Although employers may still purchase health insurance for their employees in the consumer-driven model, the patient now has a more active role in managing the cost of their care. Similarly, the patient-consumer will now have a greater incentive to work with health care providers to agree on treatments and price. The idea of empowering consumers—the patients—to make these decisions distinguishes consumer-driven health care from other more traditional models of health insurance.

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Today the health care system is in transition as the patients, health care providers, and insurers try to make sense of how this new consumerism will work. As people become increasingly conscious of price, the consumer-patient is looking to manage their health care with the same information they are accustomed to having as they make other purchases in their daily lives: namely information on price and some measure of quality. Unfortunately, people have found it difficult to get a clear picture of what health care costs, prompting some policymakers, consumer-driven health care advocates, and patients to call for policy solutions that will make prices more transparent, more quickly.

Clearly, pricing information is essential to the success of the consumer-driven health care movement, but it is equally imperative that in the zeal to push consumer-driven health care forward, federal and state governments not lose sight of the ultimate goal of empowering consumers. Indeed, policymakers should evaluate whether the push to accelerate price transparency is truly driven by consumerism. What's more, policymakers should recognize that existing government regulations have distorted price, and made pricing more complex and less transparent than it would likely be if left to the market. Ultimately, if the goal is to empower consumers and let the more market-based, consumer-driven health care model take hold, the solution to bringing health care pricing into the sunshine will not require the strong regulatory arm of government to force transparency—the market itself will compel it.

Why Prices Are Not Transparent Today

Before using legislative and regulatory action to require price transparency it is important to consider why health care prices are not already more transparent. That pricing information is not more readily available can be attributed to two primary factors: third-party payment and government regulation. First, the existing health care market has shielded patients from paying for their care.

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The hallmark of the U.S. health care system for the last 40 years has been the increasing reliance on someone other than the patient—the real consumer—paying the bill. In 1960 there was an almost even split between out-of-pocket payment from individuals and payments by a third party for personal health expenditures, but by 2004 payments by third-parties accounted for about 85 percent, leaving roughly 15 percent of the bill to individuals.[1] Looking more closely, data published by the Centers for Medicare and Medicaid Services (CMS) shows that in 2004 government payments through Medicare, Medicaid, and CHIP combined for roughly 33 percent of spending on personal health care, while private insurance accounted

for 35 percent of total spending on personal health care.[2] On a per capita basis in 2004 dollars, this spending has grown from $299 in 1970, to $5,219 in 2004, with a meager $788 coming directly in out-of-pocket costs in 2004.[3]

Second, government regulations have created a complex pricing system and market distortions. Chief among these government regulations are tax policies that favor third-party payment. Medicare and Medicaid regulations on price and practice, in particular, have also had an important role in shaping today's health care market and contribute to complexity in pricing. As Medicare, Medicaid, and CHIP have grown to comprise 33 percent of health care spending, the federal and state governments have together attempted to control cost by using "command and control" methods, hoping to artificially control price. As John Graham of the Pacific Research Institute writes, it was the creation of Medicare that caused hospital prices to go "off kilter," as using average charges in a community "motivated low-cost providers to raise their 'list prices.'"[4] The government has gone through a number of contortions to control price, utilization, and spending since creating Medicare and Medicaid, distorting price in those programs and rippling throughout the health care system in general.

A report from the Federal Trade Commission and the Department of Justice best explains the inherent problems in this "command and control" style, noting:

> Any administered pricing system inevitably has difficulty in replicating the price that would prevail in a competitive market. Not surprisingly, one unintended consequence of the CMS administered pricing systems has been to make some hospital services extraordinarily lucrative and others unprofitable. As a result, some services are more available (and others less available) than they would be in a competitive market.[5]

Furthermore, government regulation is not limited to overt price controls, but extends to other aspects of health care delivery that burden providers and further distort prices. An example Graham and other experts point to is the Emergency Medical Treatment and Active Labor Act (EMTALA), which effectively requires medical providers to deliver medical services without regard to whether payment will be made. No other business faces a similar mandate from the government to supply services without expectation of payment. As a result, providers are often left with significant holes when payment is not made, which necessitates cost shifting to make up the difference. Other experts have argued that anti-kickback regulations in Medicare limit a providers' ability to discount and stay within the law,[6] though others still have argued that providers have room to maneuver within the regulations to ensure that uninsured patients do have some ability to negotiate prices. While these rules do not limit making prices transparent, they do illustrate how difficult it can be to identify the price of any particular services.

The resulting complexity in health care pricing can be attributed to layers of bureaucratic regulations to effectively "fix" the price of health care services, combined with an emphasis on third-party payment. In today's health care system price is not only hidden from view, but entirely unrelated to what the market might establish for the service were it left to operate freely.

Promoting Price Transparency: A Role for Public Policy or for Markets?

Recent surveys highlight the growing popularity of the price transparency issue and explain its increasing attention from policymakers. Jim Frogue of the Center for Health Transformation told the Foundation's audience at the 4th Annual Policy Orientation that their polls in 2005 showed that God and the Pledge of Allegiance polled at 91 percent, and the right to know cost and quality information on health care polled at 93 percent. He said, "If you think the right to know cost and quality information about your provider is important, it's even more potent than God and the Pledge of Allegiance." More recently, a May 2006 Zogby International poll found that 88 percent of likely voters across the U.S. said that publishing price data on the Internet is a good idea.[7]

Lawmakers seem to be getting the message. In response to the interest and growing need for transparency, Congress and state legislatures across the country are looking for legislation to compel health care providers to shine light on the prices they charge. Most of the price transparency proposals require hospitals to publish their chargemasters to reveal the price of health

care, to disclose the average cost of some standard set of procedures, or to provide the patient with a written estimate of charges. There are similar requirements under consideration by Congress, including one piece of legislation introduced by U.S. Representative Pete Sessions of Texas that tries to encourage price transparency among providers by offering added liability protections. Considering the impact of government regulation on health care already, however, it is prudent to approach government's growing interest in forcing price transparency with caution.

Indeed it is possible that the market for this information is still growing, and while individuals agree that they should know this information, there has not been enough demand in the marketplace yet to deliver on that expectation.

In reality, the health care market has responded to the incentives in the system that have made price largely irrelevant to the individual consumer; it has not been impossible to get pricing information, but it has not been as important as it is becoming today. Indeed it is possible that the market for this information is still growing, and while individuals agree that they should know this information, there has not been enough demand in the marketplace yet to deliver on that expectation.

For instance, a December 2005 Harris Poll asked people if they had negotiated with a health care provider in the last 12 months and compared the results to responses from 2002. In three years, the poll showed little change in the percentage of people who had talked to their provider to negotiate the price, but those who did were more successful in getting prices lowered. According to the poll in 2002, 13 percent of people reported talking to their doctor and 10 percent reported talking to a hospital to get a lower price, with 12 percent talking to their doctor and 9 percent talking to a hospital in 2005.[8] When asked if they were successful in negotiating a lower price, 54 percent were successful when negotiating with a doctor in 2002, compared to 61 percent in 2005; 45 percent of people reported successfully negotiating a lower price with a hospital in 2002, compared with 70 percent in 2005.[9] Whether these numbers show that people are simply not aware that they can negotiate price, or are uninterested in doing so calls for too much speculation, but it is interesting to see that the percentage who attempt to negotiate price has not changed much, even with the introduction of HSAs during this period. Although the poll does not show more people attempting to negotiate price, it may be that providers are increasingly aware of the price negotiation coming with consumerism.

That the market has not demanded this information in the past says nothing about the demand for this information in the future. There is good evidence that people are enrolling in consumer-directed care plans like HSAs, and are taking an increasingly active role in managing their health care. Some providers may hope that the lack of pricing information will ensure the consumer-driven health care movement stalls early, but this is risky.

Recent numbers from America's Health Insurance Plans show that more than 3 million people have an HSA, roughly triple the number of those with an HSA in March 2005, while another 3 million have a Health Reimbursement Arrangement (both are consumer-driven health care products).[10] As the number of Americans enrolling in more consumer-driven health insurance policies increases, so will the number of people asking for this information and the number of health care providers who respond.

Michael Cannon of the Cato Institute argues that as HSAs grow and patients are sensitive to cost, the patients "will push more insurers and providers to furnish transparent, competitive prices."[11] Patients will reward providers who make pricing information available in response to the growing market, or, as Cannon puts it, "providers will publish, or perish."[12] This is, after all, the way that pricing information would evolve naturally in response to truly consumer-driven demands in health care.

It is important to consider what price transparency might look like if left solely to the market—that is, the difference between consumer-driven price trans-

parency, and price transparency by government action. Of course, it is difficult to fully predict what might happen if the drive for price information were left to the marketplace where innovation and an entrepreneurial spirit respond to these demands. By contrast, we can predict what will happen if it is left to the government: regulators will spend an inordinate amount of time debating the requirements for disclosing price. As Cannon argues, forcing doctors and hospitals to post their prices would "guarantee that the way prices are presented will serve the purposes of regulators, rather than the needs of patients."[13] Even if regulators succeed in teasing out meaningful and accurate prices, one could easily predict that providers will likely meet the letter of the law forced upon them, but not its spirit. No doubt legislators and regulators will negotiate with the health care industry on how to reasonably collect such data, and set a minimum standard for transparency. That minimum standard could quickly become the ceiling.

There is also good reason to be cautious about many of the efforts to force price transparency into the system today, raising doubts about whether they are legitimately grounded in a desire to further consumerism among individual patients. An April article from the *New York Times* reported disagreement between the White House and the Business Roundtable, a group of the country's largest employers, over the release of Medicare cost and quality data. The White House has frequently told medical providers to voluntarily make their prices more transparent or risk the government forcing them to do so, and has also "repeatedly urged private insurers to disclose" price and quality data, "saying it will help consumers choose doctors and hospitals."[14]

According to the *New York Times* article, "employers want to use the data to compare and rate doctors and to rein in soaring health costs… [and to] steer patients—workers, and retirees and their dependents—to doctors who achieved the best results and offered the best value."[15] Employers certainly bear significant cost in providing health benefits to employees under mounting costs, but the situation the *New York Times* describes is hardly consumer-driven.

Of course, there is nothing wrong with directing people to the most cost-effective care, though it is preferable to put the consumer-patient in control of these decisions when possible, rather than an intermediary. There is also nothing wrong with putting cost and quality data in the public domain so taxpayers have some sense of the value government demands for the taxpayer's dollar. In fact, CMS has just begun posting the prices Medicare pays, starting with 30 common elective procedures and hospital admissions, which are categorized by state and county, offer a range of prices, the national average payment, and the number of cases the hospital has handled.[16] CMS has also indicated that it will release common elective procedures for ambulatory surgical centers and common hospital outpatient and physician services this summer and fall, respectively.[17]

According to U.S. Health and Human Services Secretary Mike Leavitt's statement upon the release of Medicare payment information, "as we give consumers better information on how their health care dollars are spent, they will demand more value for their money, and the result will be better treatment at lower cost."[18] Yet, merely making prices more transparent will not be sufficient to lower cost; instead, the individual must have a stake in choosing the care with the best price and value.

Lasik eye surgery and cosmetic surgery serve as the best examples of how consumerism and competition have driven down cost and increased the quality of these services. In the case of lasik eye surgery in particular, most individuals pay for the service directly, prompting providers to not only post their prices, but advertise their prices and success rates to compete for business. Indeed, this is the kind of competition that consumerism will bring, along with more sensible pricing.

It may also be useful to consider how broadly reported pricing information could be used to stifle the free market. Anecdotally, many of the people who protest health care's hidden prices eventually object to the fact that prices may vary from person to person, often as a result of insurance status. Yet it is not unreasonable to expect that in a free market, which balances the values of the buyers and the sellers, some consumers may pay more for an identical product than another person. Furthermore, this is entirely different than the goal of making prices transparent. Passengers on an airplane, for instance, often pay different prices depending on when, how, and from whom they purchased an airline ticket. Neither the government nor the passengers require airlines to charge the same price for every seat, but instead al-

lows passengers to determine whether they are willing to pay the asking price for the seat.

Princeton's Uwe Reinhardt argues that medical providers "accept different payments from different payers for identical services," and such differentiation is natural in a system that does not regulate price.[19] Reinhardt compares the kind of differential pricing[i] that occurs in health care to the practice of hotels, airlines, public utilities, and universities, among others, arguing that:

> All of these industries have several things in common: They have high annual fixed costs relative to the incremental cost of producing additional services; they can segment their markets into distinct classes of customers, each with different degrees of price-sensitivity; and customers cannot resell their products among themselves, because it is either technically impossible (such as for physician or hospital treatments) or illegal (such as for pharmaceutical products).[20]

As Reinhardt infers, a regulated, price-fixed market would prevent differential pricing, but such differences in price can be expected in a free market. Importantly, price transparency should not be confused as a means to make prices uniform, but rather to make the price clear to the consumer. Of course, price transparency *could* also be used by interested third-parties seeking to better restrict or limit access to care, or to benchmark reasonable prices, which could look more like collusion or price fixing than competition.

Conclusion

Today's health care system needs a strong dose of consumerism to bring about greater competition. Consumerism and a competitive market together will result in a more sensible pricing structure and one where prices are visible to the individual patients. Although individual patients are in the best position to drive price transparency to the fore by demanding such information, it is clear that lawmakers are poised to force price transparency through legislation.

State and federal lawmakers should first ensure that government regulations do not stand in the way of price transparency by making price more complex and hidden, or hindering competition. In pursuing any additional price transparency legislation, the focus should be on empowering the patient-consumer with information.

Price transparency can best meet the goals of consumerism if providers are responsive to information from individuals, for individual use. Without question, efforts to make prices more transparent to the individual through a written estimate of charges best aligns with the notion of empowering consumers directly. The written estimate of charges recognizes the individualized nature of health care, giving the patient the opportunity to shop for care based on price and value. Furthermore, the written estimate of charges gives individual patients the most meaningful estimate of their bill.

In the end, the goal is to empower patients to act like consumers, and all efforts to speed price transparency should align with this goal.

In considering how greater price transparency can ultimately be achieved, two things must be kept in mind. First, the objective should be to achieve greater consumerism among individual patient-consumers in the name of promoting competition, not to further regulate price or restrict access to care. Second, the best means for achieving a more consumer-driven health care model is through the free market, not through increased government regulation. In the end, the goal is to empower patients to act like consumers, and all efforts to speed price transparency should align with this goal.

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[i] The Texas Public Policy Foundation also recognized differential pricing as a "perfectly rational market practice" in its December 2005 Policy Perspective, "Drug Importation: A Solution to the Cost of Prescription Drugs?"

Endnotes

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