Bigger and Better; When it comes to providing broad-based social-insurance programs, it's the government that's rational and the market that's dumb.

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REMEMBER THOSE BUMPER STICKers during the early-1990s fight over the Clinton health plan? "National Health Care? The Compassion of the IRS! The Efficiency of the Post Office! All at Pentagon Prices!" In American policy debates, it's a fixed article of faith that the federal government is woefully bumbling and expensive in comparison with the well-oiled efficiency of the private sector. Former Congressman Dick Armey even elevated this skepticism into a pithy maxim: "The market is rational; government is dumb."

But when it comes to providing broad-based insurance -- health care, retirement pensions, disability coverage -- Armey's maxim has it pretty much backward. The federal government isn't less efficient than the private sector. In fact, in these critical areas, it's almost certainly much more efficient.

To grasp this surprising point, it helps to understand how economists think about efficiency. Although politicians throw the word around as if it were a blanket label for everything good and right, economists mean something more specific. Or rather, they usually mean one of two specific things: allocational (or Pareto) efficiency, a distribution that cannot be changed without making somebody worse off; or technical efficiency, the most productive use of available resources. (There's a third possibility, dynamic efficiency, but we'll take that up in a moment.)

When the issue is health insurance or retirement security, allocational efficiency is really not what's under discussion. Nearly everyone agrees that the private market won't distribute vital social goods of this sort in a way that citizens need. Before we had Social Security, a large percentage of the elderly were destitute. Before we had Medicare, millions of the aged (usually the sickest and the poorest) lacked insurance. If we didn't subsidize medical care -- through tax breaks, public insurance, and support for charity care -- some people would literally die for lack of treatment. Market mechanisms alone simply can't solve this problem, because private income is inadequate to pay for social needs. This is one of the chief reasons why government intervenes so dramatically in these areas by organizing social insurance to pay for basic retirement and disability, medical, and unemployment coverage, and by extensively subsidizing the cost of these benefits, especially for the most vulnerable.

What's usually at issue, instead, is technical efficiency: Are we getting the best bang for our necessarily
limited bucks in these areas? The notion that the private market is, by definition, better at delivering such bang for the buck is the main rationale offered for increasing the already extensive role of the private sector in U.S. social policy. Thus, Medicare vouchers or partly privatized Social Security would supposedly engage the discipline of competition and lead to more efficient use of resources.

Liberals usually retort that social policies have other goals besides efficiency, most notably distributive justice. That's true enough, and it's another major reason why we should be profoundly skeptical of unqualified paeans to the private sector. In theory, it might be possible to design social-insurance programs that rely on the private sector but do everything that current programs do. In practice, however, privatized approaches almost invariably change the distribution of who gets the benefits, because they tend to erode common pools and subsidies (indeed, that's what their advocates often want). Yet there's no reason for advocates of social programs to cede the ground on efficiency while raising broader concerns of this sort, because in health and social policy, what is most just is also, in a great many cases, most efficient as well.

Broad-based insurance, after all, is not like widgets. In the fiercely competitive market of economics textbooks, multiple sellers appeal to multiple buyers who have good information about the comparative merits of relatively similar products. Competition squeezes out inefficiencies and yields optimal outcomes. But "markets" for social insurance don't work like this. In particular, information in these markets is both scarce and unequally distributed. This leads, in turn, to all sorts of familiar distortions on both sides of the transaction. Consumers, for example, can saddle private insurers with "adverse selection," which occurs when only high-risk folks buy insurance. The "moral hazard" problem crops up when people are insured against costs that are partially under their control, and then engage in risky behavior. On the producer side, health-insurance companies can take steps to avoid costly patients, and purveyors of retirement products can gull unwary retirees in order to enrich insiders. All of this is why insurance aimed at achieving broad and necessarily social objectives has never worked well, or indeed at all, without some government support and regulation. And it's also why it often makes sense for that support to take the form of public insurance.

Notice I say "insurance." The real issue in the big-ticket areas of U.S. social policy isn't public versus private services. It's public versus private insurance. Medicare buys essentially all its services from the private sector, and no one wants that to change. What some want to change is the degree to which Medicare is in the insurance business, and it's here that all the efficiency advantages of the public sector become clear.

Perhaps the most obvious is the advantage that neither side wants to talk about: compulsion. In the realms of public policy under discussion, however, compulsion is often necessary to make the market work. Think about what would happen if younger and healthier senior citizens were allowed to opt out of Medicare for private coverage: The broad risk-pool of the program would collapse.

Broad programs also have another big advantage: They are ridiculously inexpensive to administer. The typical private health insurer spends about 10 percent of its outlays on administrative costs, including lavish salaries, extensive marketing budgets, and the expense of weeding out sick people. Medicare spends about 2 percent to 3 percent. And Social Security spends just 1 percent. Even low-cost mutual funds have operating costs greater than that.

Here is where critics of social insurance usually pull out their trump card -- the claim that social insurance is not just inefficient but unaffordable. Maybe social insurance is, in some sense, efficient; but, these critics argue, its inexorable growth will lead the United States to financial ruin. And it is true that the growth of social insurance isn't slowed by the usual market brake of consumer willingness to pay. (If it were, as just emphasized, it wouldn't work.) But that doesn't mean that there are no brakes at all. If it did, the federal government would now be a leviathan, rather than -- as is the case -- about as large as it was in the early 1970s. Americans don't decide individually how much of their income to devote to social insurance. But, through their elected representatives, they do decide -- in a rough way, of course -- how much of the nation's income to devote. Spending has trade-offs, in the form of higher taxes and forgone priorities, and those trade-offs are visible in people's tax bills and everyday lives, and in public debate. Anyone who has followed recent political fights knows that politicians are not evading the rising costs of social programs.

What's more, the government has another advantage when it comes to holding down costs: It is a powerful negotiator. Medicare pays doctors and hospitals less per service than does the private sector, and its costs have grown more slowly than private health plans over the last 30 years, despite huge technological advances in care for the aged. Medicaid is even more austere (some might say too austere): Its payments are well below private levels, and it negotiates bargain-basement prices on prescription drugs -- something Medicare has been barred from doing. The main reason that Medicaid's costs are rising so rapidly is not that it pays exorbitantly for services but that it covers a lot more children and families than it used to, a good
thing in an era in which private coverage has plummeted. Lest government’s use of its countervailing power
to hold down prices seems illegitimate, it’s worth remembering that this is exactly what HMOs and other big
health plans were supposed to do -- but Medicare and Medicaid do it better.

To be sure, public insurance could still dampen what economists call dynamic efficiency, that is, innovation
and improvements in quality. But in some areas, like sending out retirement checks, it’s not clear where the
innovation will come from, while in others, like micromanaging providers, it’s not clear that the private
sector’s "innovations" are really worth emulating. Many of the innovations have to do with discriminating
against people at risk of getting sick, micromanaging doctors, and shifting out-of-pocket costs onto patients.
Profit-motivated entrepreneurs quickly realize that the most effective way to minimize costs is to get rid of
the people most likely to need care. This may be efficient from their perspective, but it’s obviously not
efficient for society.

Plus, when it comes to the most basic and important form of dynamic efficiency -- namely, quality control
and improvement -- the public sector is arguably as capable as the private sector, and probably more so. As
Phillip Longman has argued in an important Washington Monthly article on veterans’ health care, the
Department of Veterans Affairs (VA) has used its central power to create a model evidence-based quality-
 improvement program. Although the Medicare program still has a long way to go to match the VA, no one
disputes that it conducts more rigorous reviews of technology and treatments than private health plans do.
Indeed, private plans use Medicare’s criteria for covering treatments as their standard of medical necessity.
Information about quality is a classic public good -- everyone benefits from it, but few have strong incentives
to supply it. A large insurer with extensive data on its patients and considerable power to reshape market
practice is arguably best positioned to provide such a good.

And this is simply to focus on efficiency. As noted already, the public sector runs circles around the private
sector in terms of equity, the other major rationale for social insurance. If the current functions of social
insurance were just turned over to the private market, vast numbers of people simply wouldn’t be able to
afford anything as good as Social Security and Medicare. Conservatives like to argue that everything provided
in the Social Security package -- the annuity, disability, and life-insurance coverage -- could just be
purchased in the private market. It could, but at far greater cost for most Americans, and many applicants
would be deemed "uninsurable." All of which suggests that the claim that social programs are "inefficient" is
often just a politically correct way of saying that they don’t follow the usual market logic of giving the most to
those with the greatest means.

Liberals frequently stress the equity argument but buy into the efficiency critique because they recognize,
correctly, that the market is usually tremendously efficient. But they shouldn’t accept that premise when it
comes to social insurance. Well-functioning markets are indeed efficient for ordinary commerce, but well-
designed social insurance is almost always more efficient than its market counterparts when it comes to
dealing with the basic social risks that capitalism invariably produces. It’s high time for liberals to say what
logic, evidence, and the lived experience of citizens all show: The efficiency attack on social insurance, far
from a self-evident truth, is usually an attack on the ideal of social insurance itself -- the notion that
everyone, regardless of income or likelihood of need, should be covered by a common umbrella of protection.
And, ultimately, social insurance is good for the efficiency of society as a whole, not just because it provides
much-needed protections at a reasonable cost, but also because it allows people to deal with what FDR once
called the "hazards or vicissitudes" of modern capitalism without draconian restraints on the free play of the
competitive market.

So the next time someone complains to you about the compassion of the IRS, the efficiency of the post
office, all at Pentagon prices, tell them you’d be happy with the efficiency of Social Security, the compassion
of Medicare, all at Medicaid prices.

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