On Insurance[1]

Insurance has always been a troubling concept to me. I recall as a teen asking my father about life insurance. His answer was that the customer was betting he would die early and the provider was betting he would die later - after the premiums exceeded the payout. I learned later that the provider could also stack the deck and cancel policies when the perceived outcome began to favor of the customer.

More recently, we Americans have been on the wild ride of the Affordable Care Act, which I will not go into here. I mention it only because it has been this ride which has brought the concept of insurance back to the forefront of my attention.

After much reflection, the problem with insurance has become somewhat clear. As I have found so often in the past several years, the issues that are announced and batted about in news reports, political debates, and campaigns seem to miss the source of the malfunction entirely.

Consider the marketplace. Not the insurance market, but a real capitalistic, supply-and-demand based market. One person has a product or a service to sell. Another person wants or needs it. The seller goes through a process of determining how much the product or service costs for him to make it available on the market and adds a little for himself (called profit), after which he announces the price he will charge.

The buyer examines the product or service, and weighs the benefits of having the product to the loss of money required to obtain the product. If the benefit exceeds the cost, the sale is made.

As an aside, the price can often be different based on whether the buyer *needs* the product or just *wants* it. Marketing is the art of turning a *want* into a *need* in the mind of the purchaser.

When the cost is too high, or the benefit too low, the buyer can make a counter offer. If the seller is able to sell the item at a lower cost without actually taking a loss, the sale is made. The latter price reduction may not occur if there are others willing to pay the asking price. This is the demand side of *supply-and-demand*.

Now, I know that you all know all of that but I needed to write it out in order to set the stage for the problem with insurance.

In the process described above, there are two economic players in the game: the seller and the buyer. In the process used in the insurance industry there are three.

Insurance packages are prepared by the supplier and offered to the buyer but pricing is set by others. Sometimes the 'others' are appointed government board or panel members and sometimes the others are employees of the insurance supplier. Because no one can ever really understand what a government board or panel is up to, I will focus on the role of the employee of the insurer.

---

[1] Originallypublished September 8th, 2014.

Consider a typical visit to a Doctor for an annual physical. Insurance, as a concept and a product first arrived in the market, in 1347 in Genoa, Italy. It is modern pricing that has made insurance such a mess.

In early American history, the local physician posted his prices and the local people decided whether or not to seek medical care. The exchange of service and money was decided by the two people involved.

Today, the price of the physical exam is decided by an insurance company employee who is negotiating with the physician. The Insurance company negotiator then takes the agreed upon price back to the agency and a different employee, the agent, tells the buyer what the premium will be. The company holds the cards. The negotiator can tell the physician that he will not be listed in the *network* if he doesn't accept the price. That's the negotiator's leverage. The negotiator can tell the physician that he can charge more but that the extra would need to come from the patient. The negotiator can also tell the physician that he is <u>unable</u> to charge less than the negotiated price. The agent then tells the policy holder that the cost of the policy is based on the cost of the service to the agency.

The result of this nonsense is that one entity (the agency) negotiates pricing for the two entities that are actually involved in the exchange of services and money. It does so with enough of a margin in the deal to make a profit for itself. And, of course, the agency then gets to sell the physician malpractice insurance using the same gambit. The cost of the malpractice insurance is added to the formula to set physicians fees and passed on to the patient, less a little bit more for the agency.

The unintended outcome is that medical costs have skyrocketed. The negotiator is able to tell the physician that he can earn more money and then tells the patient that the physician is to blame, but of course *we all must have medical insurance.*

In summary, it is the setting of the cost of the service by a third party that has led to the insurance problems that we have today.

Taking a run at that government board or panel, I must point out that while the panel is intended to regulate pricing of the third party agency, it is subject to lobbying and manipulation. Without knowing the exact reason for failure, it is evident that these boards have failed in their mission.

As a footnote; recently I needed a CAT scan and was told it would be $2,000 or so. I went to an independent medical image firm and got the scan for about $200.00. The owner shared with me the fact that he owned two such companies. One took insurance and the other did not. The need for two companies was brought about by the fact that he was prohibited from charging self-pay customers the lower rate if he also accepted insurance.

This gave me hope. Perhaps capitalism and American ingenuity coupled with a massive failure of the government boards would solve the problem.