

News and Views from the Dismal Science

Dr. Econ's commentary on local, regional, national, and global economic affairs

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Free markets are like good lovers – they satisfy

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Imagine you are among the students taking an introductory economics course from me. One day you attend a particular lecture, and I start out by taking an informal “show-of-hands” survey. I ask, “How many of you are, on the whole, satisfied with the car insurance you have purchased?” “How many of you are, on the whole, satisfied with the grocery purchases you make?” “How many of you are, on the whole, satisfied with purchases you make of personal electronic consumer items, such as cell phones, television sets, MP3-players, and laptop computers?” “How many of you are, on the whole, satisfied with your purchases of apparel items?”

It's a good bet that in each case the majority of students would say that they are in fact satisfied with the purchases they make – as would the majority of the population of the United States as a whole.

But now let me ask this question of the U.S. population: “How many of you are, on the whole, satisfied with your purchase of your health insurance plan?” The answer would be dramatically different, wouldn't it?

What distinguishes the markets in the first set of questions from the health insurance market is that the former are generally free markets. “Free” does not mean that they come without regulation (most markets do). But it does mean that sellers compete for buyers' attention, and it does mean that buyers are free to switch suppliers, and that they thereby impose market discipline on sellers that do not satisfy customers.

By far the biggest problem with the health insurance market is that it is so difficult for the ultimate buyers – you and I, the insured – to switch among providers. If you have any insurance plan at all, most likely it is provided through your employer. The employer may have one or more plans for you to “choose” from, and that is pretty much where the competition for your insurance premium dollars ends. If you are not satisfied with the level of plan benefits offered, you have little choice. In most employer-subsidized health plan cases, you cannot switch until a year has passed by and a new “enrollment” period comes around. Then, most likely, you are offered the same “choice” as before – but at a higher premium. In any case, insurance companies compete for and negotiate with your employer, not with you. And your employer's interest ultimately is not your welfare, but – understandably – its own.

In contrast, if you are not satisfied with your car insurance you can switch just about any day you like. If you are not satisfied with your grocery store, you go and buy elsewhere. If you do not like your laptop, you are unlikely to buy from the same brand again. Free markets generally work because free markets generally satisfy buyers. Satisfied buyers keep sellers in check, and in business.

We are so used to the benefits competitive markets generate that we think it all quite

unremarkable. But especially amidst political election campaigns, we ought to emphasize the good work free markets do. I am raising this issue because I am not satisfied at all with what the candidates of the Democratic and Republican parties offer with regard to health care. Any hint of government involvement is quickly and vehemently decried as “socialized” medicine, supposedly because a great threat is issued to the role played by the hallowed private market.

But a *private* market that is not also a *free* market can be worse than a system that relies a bit more on government direction than our current one does. *Private companies in private markets bereft of competition are called monopolies.* Just because something is private does not mean that it is free.

One of the great ironies of the Bush-administration is that even as it is now widely recognized as among the more incompetent of any American administration ever elected to office, it actually produced one good idea – regarding health sector reform. But because this administration is so mired in incompetence, it has become virtual political suicide for anyone to pick up this one idea. (And I am not the first one to point this out.) The idea is for employer-based health plans to end. Just as we observe an increasing shift in the retirement field from employer-paid “defined benefits” to employer-paid “defined contributions” plans – with employee responsibility to manage their own retirement funds – likewise employers should increase employees’ earnings to the tune of employers’ current health plan premiums, and if one chooses to purchase health insurance the premiums should be tax-deductible. (Alternative provisions can be made, as is done now, for children, the unemployed, the retired, the indigent, and other groups.)

For example, at the moment my employer and I pay about \$10,000 a year in health insurance premiums. These income-like earnings are tax-free to me. It is a not-so-fringe “fringe benefit.” Let the employer increase my earnings by the amount of the current premiums, let me take these earnings off my income-tax obligation if I choose to purchase health insurance on my own, and let government mandate clear, inviolable minimum benefit levels insurance companies would be required to offer. (Remember, all markets are regulated.)

If a plan like this were implemented, I would actually be looking forward to receive junk mail from health insurance companies trying to win my premium dollars. I also bet that most buyers would be satisfied.