

# Florida's Innovative Medicaid Project

*By Michael Bond, Ph. D.*

Florida is beginning a historic reform of Medicaid, the joint federal-state program that is taking an ever greater share of every state's budget. Although Florida's pilot project is confined to a couple of geographic areas, the underlying reform is trail-blazing in its attempt to apply free-market principles to Medicaid.

The goal is a slower rate of price inflation for Medicaid *and* improved medical care for Medicaid's beneficiaries. The courage of Gov. Jeb Bush and the Florida Legislature in dealing with this issue should be recognized and applauded.

Medicaid's problems are widespread, severe, and rapidly worsening. Medicaid, created almost as an afterthought to Medicare in 1965, is now the largest health plan in the United States. Financed by federal funds along with state money, its growth rate is unsustainable and threatens to place most state budgets in a precarious position. Just as serious are the major quality issues that plague the program. No one in the United States receives worse health care on average than those Medicaid beneficiaries who are enrolled in fee-for-service plans.

In order to fix Medicaid, policymakers need to understand what's wrong with the existing system. In one sense its problems are simple. The checks and balances of a traditional marketplace are absent. In real markets, buyers spend their own money and act in their own interest, seeking to purchase the best quality goods and services they can find at the best prices they can obtain. Likewise, sellers acting in their own interests market their products/services at the highest possible price. Furthermore, because reducing their cost of production increases their profit/income, they have an incentive to continually innovate and become more efficient.

Medicaid, Medicare, and most private-sector health care plans don't function like a traditional marketplace. Consumers of health care are largely insulated from their purchasing decisions by government and/or insurance payments to providers. Because much care is "free," the effective demand for it is extremely high. Further, the payments set by government plans such as Medicaid are not real prices but governmental decrees. Such fancy government pricing schemes are nothing more than price controls. In the case of Medicaid, these are usually set well below what the marketplace would determine if it were free. This produces a "shortage" that takes three forms.

First, it is often difficult to obtain quality treatment from providers. Stingy payments produce "Medicaid Mills" that provide low quality care. Second, many of the providers who do agree to treat Medicaid's beneficiaries shift the costs to private payers, thereby increasing the private sector's medical inflation rate. Third, Medicaid's lack of competition and market forces undercuts any incentive to be efficient and to innovate.

This causes the medical marketplace to have much higher long-run inflation than the rest of the economy.

Granted, there is also little competition in the private sector where 80 percent of employees having only one choice in their health plan. The results of this lack of a free market are easily observable. If health care were efficient, it would have high levels of productivity growth (output per worker). From 1987 to 2001, the latest data available, annual productivity growth was 3.1 percent a year in manufacturing and 1.8 percent in the service sector. During the same period, the rate of productivity growth in health care was 0.0 percent. Any reform of health care, including Medicaid, needs to address this ominous statistic.

Florida's plan starts down this road. Beneficiaries will receive risk-adjusted credits to purchase managed care plans from providers. Unlike the current system, they will have numerous choices among providers. These plans may tailor their benefits and services to their perceived market. This type of flexibility does not exist in the current Medicaid system of mandated benefits and price controls.

The result will be much better care for beneficiaries as providers compete for Medicaid dollars by offering quality care for their patients. Beneficiaries unhappy with their current treatment may opt for a new provider. They would also have a financial incentive to seek preventive care and take care of themselves since the reform plan will allow them to earn additional benefits if they do so.

Unlike fee-for-service Medicaid, the managed-care plans will be able to effectively control unnecessary utilization and encourage the use of preventive care. Providers would also have an incentive to innovate and deliver services more efficiently because those gains in effectiveness would flow to their bottom line. Thus, one could expect effective disease-management programs that concentrate on high cost beneficiaries as opposed to fee for service that blindly pays bills. This type of effective competition will also be extended to long term care and nursing homes, replacing the counterproductive cost based reimbursement system that currently exists.

In the long run, these productivity gains would reduce Medicaid inflation and make the plan more fiscally sustainable. Equally important, the quality of Medicaid care will improve. In the absence of these reforms, the outcome will be soaring taxes, even lower medical quality, and the outright rationing of health care. Florida has taken the first step in preventing those dire consequences. Free markets and competition, not government regulation and control, will fix Medicaid's serious problems.

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