Why Healthcare Is So Expensive

By: Elliot Eisenberg, Ph.D., GraphsandLaughs LLC

HOME BUILDERS ASSOCIATION OF THE FOX CITIES

While there are many reasons why healthcare spending is growing much faster than the economy - including an aging population and the rising cost of prescription drugs - one problem that gets virtually no attention and is a primary cost driver is cross-subsidies. The reason cross-subsidies exist in the first place is because lawmakers want to subsidize healthcare costs for the poor, the sick, and other potential voters - which is well meaning - but lawmakers do not want to raise taxes to pay for these programs. So they hide the taxes they should impose in the form of cross-subsidies.

Let me explain. If someone with no money walks into an emergency room and needs care, they get care. But to recover the cost of services provided to the indigent, hospitals must overcharge everybody else. Making matters worse, Medicare and Medicaid do not pay the full amount of their service cost. As a result, hospitals must substantially overcharge everybody else, and that unlucky bunch is patients with private insurance and those who pay cash.

Of course, giving free or subsidized healthcare to some by overcharging paying customers is essentially imposing a tax on those who can pay in order to subsidize those who can't or won't. But - and this is the key - this hidden tax does not appear anywhere. As such, it is politically costless, and that's why it is so appealing to politicians. If that were all, it would not be so bad. But it gets worse, much worse.

"Cross-subsidies are much more inefficient than raising taxes and spending the revenue on, in this case, healthcare. Here's why. In an ideal market, if a hospital or doctor is going to overcharge some patients, those patients will have an incentive to shop around for a cheaper insurance plan."

Cross-subsidies are much more inefficient than raising taxes and spending the revenue on, in this case, healthcare. Here's why. In an ideal market, if a hospital or doctor is going to overcharge some patients, those patients will have an incentive to shop around for a cheaper insurance plan. That insurance plan could be cheaper if it sends patients to hospitals and doctors who don't overcharge. But if enough such plans were to exist, the entire system would fail because these new low-cost providers would drive the high-cost providers out of business and the poor would not be served. Thus, the introduction of cross-subsidies must be accompanied by a prohibition on competition. One of the ways we see this lack of competition manifesting itself is insurance plans such as bronze, silver, and gold all offering the same services.

And once there is no competition, there is no incentive for any non-competitive service providers to innovate for better care or lower costs, and that, in turn, drives up costs for everyone. If you are old enough, you remember that prior to the 1980s, local phone calls were cheap, often free. That was because long distance calls were very expensive; there was cross-subsidy from long distance calls to local calls. Of course, firms wanted to compete to provide overpriced long-distance calls, but the system would have unraveled. So the federal government gave AT&T a monopoly and, in that way, kept competitors out and prices up.

Once there is no competition, be it in telecommunications, airlines, trucking, banking, or stock trading, inefficiencies multiply and prices rise. Returning to healthcare, because of this lack of any meaningful competition, consumers know the cost of nothing they consume and care even less. What kind of market operates well when prices are well hidden? If there were real price competition, consumers would be bombarded with ads boasting of better prices and outcomes and we would all be winners.

Increasing taxes and spending, while hardly ideal, sure beats cross-subsidies and the attendant monopolies that drive up costs, prevent firm entry, and eliminate innovation. Until cross-subsidies are eliminated, US healthcare costs will continue to spiral out of control and we will be able to do nothing more than wish for a competitive, innovative and efficient healthcare market.

Read more articles like this at http://bit.ly/HBAFCArticles

Elliot Eisenberg, Ph.D. is President of GraphsandLaughs LLC and can be reached at elliot@graphsandlaughs.net. Visit econ70.com for his daily 70-word economics and policy blog. You can subscribe and have the blog delivered directly to your email by visiting the website or by texting the word "BOWTIE" to 22828.