



BRIEF ANALYSIS

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How Much Should We Spend on Health Care?

By Greg Scandlen

Here we go again. Another round of health insurance rate hikes. This time premiums are going up anywhere from 10 percent to 20 percent and more. And health care costs generally are rising at two to three times the rate of inflation.

According to some critics, the culprit this time is alleged to be prescription drugs — not the price of drugs, but the newest round of expensive medications that never existed before. The drug manufacturers, it is charged, are creating demand where none existed by advertising directly to consumers, often on television.

Such advertising probably does create demand. If fewer people know about the drugs, fewer will ask their doctors about them and thus fewer drugs will be prescribed. Is that diminution of demand a good thing? Not if you are the one who has allergies or arthritis or impotence.

Health Care Costs vs. Other Costs. But advertising isn't the problem. We advertise potato chips and soda pop. More people buy these products because they are advertised, and spending on snack food increases. But no one gets upset.

It's true that the United States spends a lot of money on health care — \$1,023 billion in 1998, according to the Bureau of Economic Analysis. But, as the table shows, we spend a lot of money on a lot of things. Who is to say what the right amount is for any of those expenditures?

If we spent less on health care, would we spend more on food? Or recreation? Or transportation?

Perceptions Over Time. The health policy community has been in a state of periodic panic over health care spending since the early 1970s. Observers then complained about “spiraling health care costs,” which equaled 7 percent of the gross national product in 1970. President Nixon imposed federal wage and price controls in 1971, primarily because of growing health care costs.

But by 1975 health care was absorbing 8.3 percent of the GNP, and the crisis worsened. Today, health care is nearly 15 percent of the economy and we have somehow managed to survive.

While policy-makers seem to be persistently vexed over health care spending, most Americans think we spend too little on health care. Responses to annual surveys taken from 1973 to 1998 have been amazingly consistent — about two-thirds of Americans think we spend too little, and less than 10 percent think we spend too much. [See the figure.]

Who Pays? Why do the pundits and the people have such divergent views? Because few Americans have any idea what health care costs or how much is being spent on their behalf. Someone else is paying the bill. That other party may be the government, an employer or an insurance company. For at least 40 years the portion of health care services paid directly by patients has dropped every year, while the portion paid by third parties has increased.

Because consumers are free of any concern about costs, payers are forced to step into the middle of the medical transaction and exercise their own judgment

Selected Personal Consumption Expenditures in the U.S., 1998 (billions)

Food and tobacco	\$907.4
Clothing, accessories, jewelry	367.9
Housing	855.9
Household operation	646.5
Medical care	1,032.3
Personal business	528.6
Transportation	647.4
Recreation	494.7

Source: Bureau of Economic Affairs, U.S. Department of Commerce, from *World Almanac*, 2001, p. 132.

about what is worth paying for. But their judgments may be at odds with the values of patients and doctors. For instance, a payer may decide that new mothers can go home within 24 hours of giving birth, but some mothers may disagree and resent the pressure to leave the hospital so quickly. Lacking market clout, ordinary voters turn to politicians to correct what they view as unfair constraints. And as politicians succeed in disarming the payers, the war against increasing costs is bound to be lost.

One Size Doesn't Fit

All. Legal remedies are clumsy. A new law, like a mandate to cover certain treatments or providers, must be applied to everyone, including to people who don't care or are opposed to the provision. A requirement that an insurance plan cover abortions and contraceptive devices must apply to all insurance plans, even those purchased by religious objectors to these procedures. Some people have suggested using "conscience clauses" to exempt churches from such requirements. But people who don't work in a church setting also may have equally strong convictions about the morality of the provision.

This is the kind of nuance that laws can never address, but that markets can address very well. Market systems enable all individual consumers to purchase exactly those goods and services they value and to shun those they don't. Consumers make daily decisions about how to best spend their resources to get the most value from their funds. We get not only chocolate and vanilla, but 29 or more other flavors as well. Only 2 or 3 percent of

the population may like pistachio ice cream, but the market serves it to them, just like the more popular flavors.

Needed: Consumer Choice. The question is not whether one trillion dollars is too much or too little to spend, or that we would be better off spending some of that money on something else. Consumers never decided to spend a trillion dollars on health care, at least not rationally. That money did not have to compete with the rest of the economy for the hearts and minds of the

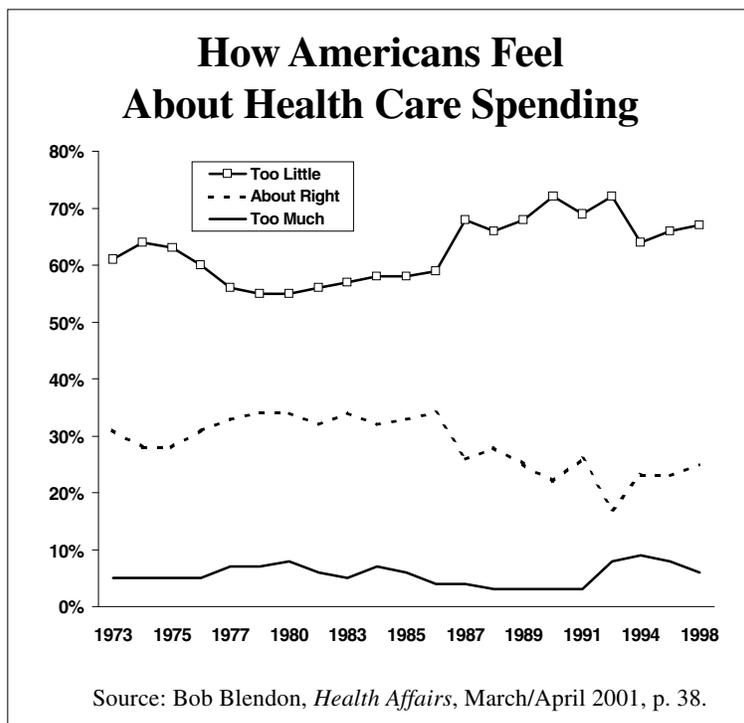
American people. We don't know whether people feel they are getting their money's worth, because they never knew how much money is being spent.

If consumers were in control of their own resources, they might decide to spend far more or much less. However, it seems likely they would change their pattern of consumption. Some might spend more money on chiropractors or home health or nurse practitioners and less on doctors and hospitals. They might prefer a nurse midwife over an obstetrician, and they

might prefer home birth over a hospital stay, then spend the savings on a new crib for the baby.

But under today's system of health care financing, we cannot know what consumers prefer because they must accept whatever the insurance company, the government or their employer will pay for. And people won't get excited about premium increases when they perceive that someone else is paying the bill.

Greg Scandlen is a Senior Fellow with the National Center for Policy Analysis.



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