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The Tax-and-Spend Health-Care Solution

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Why is paying for health care such a mess in America? Why is it so hard to fix? Cross-subsidies are the original sin. The government wants to subsidize health care for poor people, chronically sick people, and people who have money but choose to spend less of it on health care than officials find sufficient. These are worthy goals, easily achieved in a completely free-market system by raising taxes and then subsidizing health care or insurance, at market prices, for people the government wishes to help.

But lawmakers do not want to be seen taxing and spending, so they hide transfers in cross-subsidies. They require emergency rooms to treat everyone who comes along, and then hospitals must overcharge everybody else. Medicare and Medicaid do not pay the full amount their services cost. Hospitals then overcharge private insurance and the few remaining cash customers.

Overcharging paying customers and providing free care in an emergency room is economically equivalent to a tax on emergency-room services that funds subsidies for others. But the effective tax and expenditure of a forced cross-subsidy do not show up on the federal budget.

Over the long term, cross-subsidies are far more inefficient than forthright taxing and spending. If the hospital is going to overcharge private insurance and paying customers to cross-subsidize the poor, the uninsured, Medicare, Medicaid and, increasingly, victims of limited exchange policies, then the hospital must be protected from competition. If competitors can come in and offer services to the paying customers, the scheme unravels.

No competition means no pressure to innovate for better service and lower costs. Soon everybody pays more than they would in a competitive free market. The damage takes time, though. Cross-subsidies are a tempting way to hide tax and spend in the short run, but they are harmful over years and decades.

We have seen this pattern over and over. Until telephone deregulation in the 1970s, the government wanted to provide telephone landlines below cost. It forced a cross-subsidy from overpriced long distance and a telephone monopoly to keep entrants out and prices up. The government wanted to subsidize small-town air service. It forced airlines to cross-subsidize from overpriced big-city services and enforced an oligopoly to keep entrants from undercutting the

profitable segments. But protection bred inefficiency. After deregulation, everyone's phone bills and airfares were lower and service was better and more innovative.

Lack of competition, especially from new entrants, is the screaming problem in health-care delivery today. In no competitive business will they not tell you the cost before providing service. In a competitive business you are bombarded with ads from new companies offering a better deal.

The situation is becoming ridiculous. Emergency rooms are staffed with out-of-network anesthesiologists. Air ambulances take everyone without question, and Medicare, Medicaid and exchange policies underpay. You wake up with immense bills, which you negotiate afterward based on ability to pay. The cash market is dead. Even if you have plenty of money, you will be massively overcharged unless you have health insurance to negotiate a lower rate.

Taxing and spending is not good for the economy. But it's better than cross-subsidization. Taxing and spending can allow an unfettered competitive free market. Cross-subsidies must stop competition and entry at the cost of efficiency and innovation. Taxing and spending, on budget and appropriated, is also visible and transparent. Voters can see what's going on. Finally, broad-based taxes, as damaging as they are, are better than massive implied taxes on very few people.

This is why continued tinkering with the U.S. health-care system will not work. The system will be cured only by the competition that brought far better and cheaper telephone and airline services. But there is a reason for the protections that make the system so inefficient: Allowing competition would immediately undermine cross-subsidies. Unless legislators swallow hard and put the subsidies on the budget where they belong, we can never have a competitive, innovative and efficient health-care market.

But take heart—when that market arrives, it will make the subsidies much cheaper. Yes, the government should help those in need. But there is no fundamental reason that your and my health care and insurance must be so screwed up to achieve that goal.

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