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Hey, Big Spender

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HIGHLIGHT: Controlling costs by spending more?

A recent *New York Times* editorial sermonized on the need to fight health care inflation. It declared that the Obama Administration "seems headed in the right direction to finally slow the rate of growth in health care spending." That is nonsense.

Health care spending equals the sum of public and private spending on health care. The Obama Administration hopes to spend an additional trillion dollars on subsidized health insurance over the next decade. The only way such added federal spending could possibly "slow the rate of growth in health care spending" would be for private spending to fall by \$1 trillion. (See "*Heads Up*")

Total health care spending did stop rising faster than the economy during the Clinton Administration, when the government stopped paying for a rising share of the costs: Spending on health care was 13.6% of GDP in both 1993 and 2000. By no coincidence, government spending stabilized during those years, accounting for 43% of health care outlays in 1993 and 43.2% in 2000. Once government resumed paying a growing share of the bills, combined public and private spending began rising again, to 16% of GDP.

Congressional Democrats seem eager to tax the stuffing out of both sellers and buyers of private health insurance. Maybe their "reform" plans really do aim to shrink private health insurance benefits by enough to compensate for their extra spending on public insurance, subsidies and Medicaid. Unless the new federal spending reduces private health care spending by more than a trillion dollars, however, their plans must push overall health care spending up, not down.

Adding to the confusion, President Obama talks at once about slowing the growth in the federal government's health care spending and increasing federal spending on health care. "Let me be clear," he says, "if we do not control these costs, we will not be able to control our deficit." If the President is not claiming that more spending is really less, what is he saying?

The explanation of such mysteries may rest in the *Times* editorialist's inability to grasp the distinction between prices and quantities. It turns out that health care spending has not been driven up by runaway inflation but by runaway federal spending. Government is paying for a larger quantity of medical bills, not merely a rising price per procedure or product.

The Consumer Price Index for medical care slowed its growth dramatically in the 1990s, when federal health care spending was relatively contained. Medical care inflation slowed from nearly 10% at the end of 1990 to less than 3% in 1997, and it was only 2.8% over the past three months. Prices of medical services tend to rise faster than the CPI for the entire economy, but that is typical among all labor-intensive service industries. From 1996 to 2008 the CPI for physicians' services rose by 3.1% a year, for example, but prices of nonmedical services also rose by 3.1% a year.

You can see the bloating influence of government by looking at medical goods and services that are almost never financed by "free" government money: dental care, over-the-counter drugs, hearing aids and eyeglasses. In such cases nobody frets about inadequate competition, poor service or "runaway inflation."

Hospital fees are another matter, having risen nearly twice as fast as over-all medical care. That is no surprise: Government agencies pay nearly 60% of hospital bills, while private insurance (with more incentive to be careful) pays 36% and consumers pay 2% out of pocket. President Obama has a strangely inverted concept of who is throwing too much money at hospitals. He thinks it is private insurers and consumers, rather than taxpayers. In a July press conference he warned that if the government does not spend yet another trillion dollars on health care, "your premiums and out-of-pocket costs will continue to skyrocket."

Premiums? The CPI has kept track of health insurance only since December 2005, but the index has risen by an average 2.8% a year since then. Out-of-pocket costs? Less than 15% of all personal spending on health care is paid for out of pocket, according to OMB director Peter Orszag, down from 26% in 1985.

Spend more in order to spend less? That's double-talk.

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