Health Care Is Different—That's Why Expenditures Matter

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HEALTH CARE EXPENDITURES IN THE UNITED STATES have been increasing much more rapidly than the rest of the economy over the past 30 years. The average gap, 2.8% per annum, results in health care's share of the economy doubling every 26 years.[1] Why does this matter? Would it matter if expenditures for personal computers were increasing 2.8% per annum more rapidly than the rest of the economy? The appropriate response would be, "So what?" Concern about health care expenditures is often attributed to the large role of these expenditures in the federal budget and the effect on the deficit.[2] But that is not the whole story. A dollar spent on health care is not a priori more fiscally toxic than a dollar spent on transportation or education or any other item in the government budget. Moreover, health expenditures in the private sector have also been increasing rapidly. What matters most are the characteristics that distinguish health care from other goods and services: great uncertainty about an individual's need for care, the essential nature of some care, and the ambiguous role of competition. These characteristics help explain the distinctive institutional features of health care and their consequences.

Uncertainty About an Individual's Need for Care

In any year, the incidence of illness is distributed very unevenly among the population. Many millions of individuals use no health care, while a small proportion, about 1 in 20, account for about half of total health care utilization.[3] Much of an individual's high utilization is unforeseen: the sudden myocardial infarction, the diagnosis of cancer, the nearly fatal automobile crash, and the like. Individual demand for most goods and services is much more predictable. Because individuals are at risk of generating health care bills far in excess of their ability to pay from income or savings, there is widespread demand for health insurance. In many countries this demand is met by publicly supplied insurance; in the United States private insurance (subsidized by government) is still the primary mode, but public insurance such as Medicare and Medicaid and direct public provision of services through the Veterans Health Administration, county hospitals, and other government agencies account for almost half the total.[4] Insured patients tend to "overconsume" health care relative to other goods and services.[5] If there were third-party payments for personal computers, expenditures for PCs would surely be greater than at present. Even if consumers did not purchase more computers, many would be tempted to purchase top-of-the-line models. To offset overutilization of health care, a variety of constraints are attempted, including fixed budgets for hospitals and physicians, quantitative limits on supplies of personnel and facilities, and alternative payment mechanisms such as capitation.

Essentiality of Care

Some health care can make the difference between life and death or between a full functioning life and one of pain and disability. Given the essential nature of some care, no developed country permits access to be determined solely by individual ability to pay. Every developed country engages in some redistribution; the poor who are ill obtain care paid for by others. Personal computers are not viewed the same way; if access to a computer were regarded as essential, computers would be subsidized for poor individuals. To the extent that government redistributes health care, it must increase revenues through taxes (or similar measures), which have a negative effect on the overall economy by discouraging work, saving, and investment.[6] Some redistribution is sought through the private sector such as when insurance companies are required to charge healthy persons and sick persons the same premiums.

The day after passage of the Patient Protection and Affordable Care Act of 2010 (ie, "Obamacare"), Leonhardt[7] noted that the most important result of this act is to redistribute care to the poor and sick with the wealthier and healthier bearing the cost. To accomplish redistribution equitably and prevent "free riders," every country uses some form of compulsory participation. Many do so through tax-supported universal coverage; the Obama reform does it through a combination of mandates, taxes, income-tested subsidies, and regulation of private insurance.

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The Ambiguous Role of Competition in Health Care

Expenditures for most goods and services are not of concern for public policy, in part because they are the result of interaction between supply and demand in competitive markets. Given sufficient competition, theoretical and empirical research concludes that a commodity's price and quantity reflect its real cost to producers and its real value to buyers. That level of competition does not exist in many health care markets. Furthermore, in numerous situations it is doubtful whether society would benefit if it did.

For instance, economies of scale prevail in hospital care. How many hospitals are needed in a community of 100 000 population for greatest efficiency? Probably only one with about 225 beds. Even in a city of 1 million, where several hospitals could efficiently compete in providing ordinary acute care, quality of care would be higher and costs lower if neonatal intensive care, open heart surgery, organ transplantation, and other specialized services were each provided in a single hospital. The production of personal computers also benefits from economies of scale, but because the relevant market is national rather than local, it can sustain a sufficient number of producers to keep the market competitive.

Another example is the provision of physician specialty care, such as urology, neurology, or interventionist radiology. Even if a community were large enough to require the services of several physicians in each specialty, patients would probably be better and more efficiently served if physicians worked cooperatively—exchanging information, covering patients for one another, sharing specialized technology and assistants—than if each physician was an "independent firm" competing with colleagues. But without competition, it is not possible to automatically assume that the price and quantity (and therefore, the level of expenditures) is socially appropriate.

The conclusion that a competitive market for a good or service will result in an appropriate level of expenditures usually assumes informed consumers. A special problem for competition in health care is that consumers are frequently poorly informed. In most cases a patient has symptoms—such as fever, pain, or headache—but does not know the cause or what treatment if any should be undertaken. Given the complexity of the current medical diagnostic and treatment options available, even well-trained physicians must make decisions while facing considerable uncertainty. Which of 4 different imaging devices is the most appropriate for this patient? If the diagnosis is hypertension, which of the numerous different drugs should be prescribed? Is hospitalization needed, or can the patient be treated on an outpatient basis? Which stent is more appropriate, bare metal or drug-eluting? The notion that the typical patient, even with a computer and an electronic medical record, would be able to make these decisions correctly gives too much credence to "free market ideology" over the complexity of health care. The fact that competition cannot be relied on to result in a socially appropriate level of expenditures for much of health care explains the widespread presence of government regulation and self-regulation through professional ethics.[8] Neither solution is perfect, but competition alone is not a realistic option for many health care markets.

In summary, the distinguishing characteristics of health care and the institutional features they induce are a more fundamental source of concern about health care expenditures (private as well as public) than their role in the federal budget.

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