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## **Socialism and Medicine, Part 2**

**by William L. Anderson**

In 1965, the U.S. economy was unquestionably the most productive and vibrant in the world. Doctors and hospital administrators were enjoying high revenues, and at that time health insurers generally did not worry about such things as “cost containment.” Life in the medical field was a big party, and people were paying the bills without asking, especially those with deep pockets.

It is no surprise, then, that all of this new-found largess would attract a number of new entrants into the medical field. Doctors discovered their incomes rising, but a number of other people also discovered that the lure of profits into the field was a big draw for drug companies and creators of medical devices. The once semi-sleepy world of county hospitals and quaint doctors who made home visits with their medical bags had leaped into the modern age.

There are two aspects of new potential profits that one must recognize. First, as more entrants come into a particular field of business, they compete for the existing resources, which drives up the prices of those resources, or what we in economics call *factors of production*. This is a fancy way of saying that in the short term new entrants will drive up the costs.

Second, entrepreneurs do not simply do business the way everyone else does; instead, they find new resources or take existing resources and change them to create new goods or to enhance existing services. Over time, in a free-market setting, entrepreneurs *lower real costs* to customers, especially when one examines the entire picture.

Consider the MRI (magnetic resonance imaging) device by which doctors are able to “take pictures” inside the human body without invading it. This device is much more versatile than an X-ray machine, which is far more limited in what it can detect.

Thanks to the MRI, doctors can engage quickly and painlessly in exploratory surgery to find damaged tissues without having to engage in “invasive” procedures (i.e., cutting someone open). While the MRI is expensive both to purchase and to maintain, nonetheless it is a *cost-saving* device because it shortens the time for critical examinations and requires fewer people to perform more medical assessments.

The genius of this machine is not simply in what it does, but rather that someone had the foresight to recognize its medical potential. That is the heart of entrepreneurship, and it is as active in the health-care field as it is elsewhere.

### **Costs and third-party payers**

When people make economic decisions, they weigh costs and benefits, something that is hardly profound. However, the ability to accurately examine costs and benefits depends on having accurate information, and the presence of third-party payers changes that situation considerably.

For a simple example, let us assume that I am purchasing a house. In one scenario, I must make the payments myself, with no help from anyone else. In the other scenario, someone else is making all of the payments for me, and no hard-and-fast cost constraints are given. It is obvious that I would be much more careful in the first scenario than in the second. In both situations, I would be purchasing a house, but the economic calculus in the two cases would differ greatly.

If I were building the house, it is obvious that in the different scenarios I would approach all of the various factors that go into the house differently. If I had unlimited funds, I could purchase all of the finest materials, hire an architect, and generally build a luxury villa. However, if I am paying for it, I will go with what I can afford, given my other obligations in life.

It is clear that economic calculation is much clearer and more exact if one is not depending on third parties for payment, so it is not surprising that when insurance companies and government officials realized they did not have bottomless pits of cash to pay to medical professionals, they began to limit what they were willing to pay. Despite the claims of economist Paul Krugman, who writes a column for the *New York Times*, and others who advocate socialist medical care, *all* third-party payers, be they insurance firms or governments, face cost constraints and have sought to limit their own exposure.

At the same time, the system has worked to make things more costly on the supply side. For example, state legislatures are fond of mandating new programs requiring *all* private insurers to provide certain benefits, such as yearly mammograms or mental-health coverage. Invariably, as health care becomes increasingly politicized, politicians seek to force insurers to carry the programs that are politically popular, even if they drive up costs and make insurance less affordable for private customers.

Third-party dependency has another drawback, and that is that the entities paying the bills also try to narrow the choices to familiar practitioners and treatments. Ordinarily, the presence of more choices also means more competition and lower costs, but in the heavily regulated field of medical care, things often are turned upside down.

To give a personal example, in the summer of 2004 doctors found three 90 percent blockages in my arteries. In a normal situation of choice, I could have gone with stents (what my

doctor wanted to do) or tried alternative remedies, such as chelation therapy or taking vitamins. However, my insurer would pay for only one remedy, and that was the placement of stents. Thus, my insurer ultimately was billed for \$31,000 (stents placed in July and December 2004). I paid nothing. Had I chosen a different treatment, it would have meant thousands of extra dollars from my pocket. Free was better, even if it might not have been better, medically speaking.

Was that the most cost-effective treatment? Who knows? Was it the correct treatment? Again, who knows? Between the political pull of the American Medical Association and the various state and federal regulations that govern nearly everything that doctors, nurses, and hospitals do, it is difficult to know which treatments work and which do not work. (The doctors' lobby historically has referred to any kind of alternative medicine, be it homeopathy, chiropractic, or the like, as "quackery," and insurers do not like to pay for "quacks.")

Likewise, I, like other patients, do not find incentives for making cost-effective decisions. In fact, it is safe to say that in medical care, I and other direct health-care consumers do not make many choices at all. I pay a fixed amount to the insurer and, while there are some co-pays for doctor visits, there is no incentive for me to spend less than what I have paid in premiums. The incentives in such a situation obviously are skewed, creating a situation that is ripe for abuse. Moreover, when economic calculation no longer makes sense, we then see situations in which someone has to choose between which fingers to have sewn back on his hand, as Moore points out in his documentary *Sicko*.

### **The wrong diagnosis**

This is the world of insurer-led medical care that Moore calls "free-market." It clearly is not. American medical care is heavily regulated on all fronts, and is dominated by third-party payers who are under pressure to keep from giving away the store. (That includes government payers and providers of medical care, which also face real cost constraints and often are stingier than private insurers.)

Given the frustration that people have with the present third-party system, some are declaring that it is the *fault* of private enterprise. Give government the full reins of medical care, *and* we will see an improvement both in quality of care and overall costs, a message that Krugman has trumpeted from his position at the *New York Times* and Princeton University, where he serves on the economics faculty.

If we wish to gain a sense of what to expect with government-sponsored medicine, we should look to Canada to see why the system there has its detractors — and defenders. However, before looking at our neighbor to the north, perhaps we should look at the United States, especially since government payments account for nearly half of all medical expenditures in this country and governments at state and federal levels strongly regulate all facets of medical care.

In other words, while we can draw comparisons with Canada, we are *not* comparing a free-market system of care to “socialized medicine.” Instead, we are comparing two systems dominated by third-party payments, the Canadian being 100 percent tax dollars, and the American system a combination of taxes and private dollars. The heavy regulation of private insurers, including the many mandates that are placed on insurance companies by all levels of government, guarantees that the medical system in existence here will be semi-socialistic — and costly.

The last statement will come as a shock to people who are convinced after reading Paul Krugman’s *New York Times* columns that medical care in this country is pure free enterprise and that it is free enterprise that is driving up the costs. In a recent column, Krugman declared that medical care in the United States is costly because of high-quality medical capital such as MRI and CAT scan devices. His reasoning goes as follows:

- Those devices are expensive.
- Doctors charge a lot for tests from those machines, since the devices are costly.
- Because the tests are expensive, they drive up health care costs.

If Krugman were not an economist, perhaps he could be forgiven for constructing such a faulty chain of economic logic. First, and most important, he is not examining what the CAT scan and MRI devices *replace*. They permit doctors to quickly engage in *exploratory surgery in which they are able to quickly diagnose different disorders*. Before the advent of these devices, doctors had to perform invasive procedures for which there was a recovery period; today, they are able to quickly diagnose problems *at a fraction of the total costs that once were involved in such examinations*.

In other words, when one factors in time, as well as the fact that the devices ensure more-accurate diagnoses, as well as increase survival rates from certain kinds of illnesses, one can see that they are not the source of high-cost medical care. Instead, they *improve* the quality of medical care and, when one looks at the big picture, actually lower real medical costs.

Second, Krugman wrongly appeals to the discredited cost-of-production theory of value, which dominated economics until “marginalists” such as William Stanley Jevons and Carl Menger in 1871 independently produced path-breaking works that demonstrated conclusively that demand *for the final product* is what gives value to the factors of production and capital goods, not the other way around. While this may look to be “technical” economics talk, it actually is something that is very important in explaining why Krugman and others like him are so wrong when they advocate government medical care.

## **Capitalism and socialism**

According to Krugman and others, medical care in the United States is expensive because it costs a lot of money for people to have tests done by means of MRI or CAT scans. Thus, if you wish to have less-expensive medical care, then you do away with such expensive items or more strictly ration them.

For example, I work in Allegany County, Maryland, and we have three MRI devices in this county of about 80,000 people. I have had two MRIs done, which were performed the same week my doctor scheduled them for me. Montreal, Canada, on the other hand, has about 3.6 million people in its metropolitan area, and there also are three MRI devices, one for more than a million people. Anyone needing an MRI there has to wait at least six months.

Why the difference? The answer lies in the somewhat obscure fact that under a socialistic system, capital becomes a liability rather than an asset. The reason is that under a system of private profit, capital is used by its owners to provide an income; in socialism, capital does not provide an income to anyone. Rather, it is an expense item and nothing else.

The owners of the MRI devices in Allegany County charge a fee for their use. In my case it was \$1,200. The alternative would have been for doctors to open my knee and look inside and then decide whether or not to do surgery. Such a procedure not only would be invasive and have resulted in my being laid up for several weeks, but it also would have been much more expensive in *total costs* that would be paid, including costs my employer (and I) would have had to bear, since I could not have been in a classroom for several days.

As it was, I missed no time from work to have the MRI, and when it showed a tear in the medial meniscus, my surgeon was able to home in immediately on the problem. When I had surgery, I was out of work for just a couple days. If one looks just at the cash outlays for the surgery (paid by my insurer, of course), there is no doubt that the entire procedure was more expensive than it would have been in Canada. If one looks at the opportunity cost of waiting, of invasive surgery, and of time off from work, the numbers no doubt are much closer together.

The owners of the MRI devices in Allegany County earn an income from those devices, which obviously cost more than a million dollars apiece. Thus, as long as it is profitable to the owners to purchase and employ them, they will do so.

Take the sets of incentives faced by a hospital administrator in Canada, however. Because he cannot charge for any services, an MRI device will not provide any income for his hospital; thus, it represents only an expense. Furthermore, such capital expenditures would serve to take money away from other expenses, such as increasing salaries for unionized nurses.

In a capitalist system, such decisions are made within the nexus of *economic calculation*, in which one makes economic choices based on the prospect of profit. For example, if it could be shown that a new MRI or CAT scan could have a good return on investment, it would make sense for a medical center to purchase such a device. However, in a system such as those that exist in

Canada and European countries, *other factors govern whether or not such devices are purchased, and the factors almost always are political.*

It has long been understood that politically connected people are moved to the front of the line for special medical procedures, which causes no small amount of envy among Canadians who might have to wait six months for an MRI and more than a year for knee or hip replacements. (Even supporters of Canadian medical care acknowledge that there are long waiting times, but insist that government “is doing something about it.”)

Jane Orient, a practicing physician who has written volumes on socialism and health care, writes,

It [medical care in the United States] is a two-trillion-dollar pot of gold, one seventh of the American economy. It is certainly a great magnet and motivation for all types of people. It attracts people because of fear and greed, and it attracts people because of their better instincts. It is also the third-rail of politics. Once people are given some sort of entitlement to medicine, it can never be taken away. Let us not blame the free market for that; there has been no free market in medicine for at least 60 years, thanks to the public-private partnership, the federal tax code, and all types of government intrusions and incentives.

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