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The high costs of Medicare's low prices

By David Goldhill

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Steven Brill's recent Time magazine cover story, "Bitter Pill: Why Medical Bills Are Killing Us," is an extraordinarily well-reported look at medical pricing, demonstrating that high health-care prices have little relationship to underlying cost. For many commentators, the much lower prices paid by Medicare suggests an obvious solution to our health-care problems — "Medicare for all." There's only one problem with this "obvious" solution: Medicare has been a primary driver of the explosion of health-care costs in the United States despite — and perhaps because of — the low prices it pays.

Over the past decade, Medicare's spending per beneficiary has risen at roughly the same rate as spending for privately insured patients. Medicare's supporters have a simple explanation: Americans are living longer, and this is driving up the program's costs. But Medicare's own data say that a much more important factor is the growing intensity of use: more demand for care at every age.

In the mainstream of our health-care debate, this growth in seniors' demand is considered organic — a need to be fulfilled. But this extraordinary growth in volume is better understood as a provider reaction to the perverse incentives of low prices. Faced with buyers focused on volumes — such as private insurers — the health-care industry prices high; when dealing with buyers focused on prices — such as Medicare and Medicaid — the focus shifts to raising volumes, especially of more-costly procedures. Both strategies demonstrate the industry's enormous market power.

Medicare beneficiaries get a lot of health care, and these amounts grow every year. In 10 years, the number of CT and MRI scans per beneficiary more than doubled; hip replacements increased by 36 percent between 1997 and 2007. One out of three Medicare beneficiaries now has at least one surgery in the year of his or her death; even 20 percent of 90-year-olds do! The average 75-year-old is on five prescription drugs. Here's a fact you rarely hear about Medicare: Annual spending just on those in excellent or very good health was an astonishing $5,437 per person in 2008.

If you have relatives who are Medicare beneficiaries, you've probably experienced the medicalization of senior years — the perverse fate of the healthiest generation of seniors in history. But although the past years have seen a slew of insider accounts discussing the rise in unnecessary tests, diagnoses and even treatments far beyond any benefit to the patient, little awareness of the harm inflicted by growth in medical volume has seeped into policy debates.

The explosion of "care" under Medicare is an assault on the very bodies of our seniors. Health care is often a real benefit, of course, but all of it involves physical costs in side effects, recovery periods and the risk of error. An extensive survey by Medicare's inspector general noted that one in seven hospital admissions of a Medicare beneficiary resulted in an "adverse event" from care; an unbelievable 1.5 percent — translating to 15,000 patients per month — experience an "event" that contributed to their death.

It's difficult to hear that pricing policy may drive the very nature, and not just the cost, of health care, but "diagnosis creep," the substitution of expensive drugs for cheaper ones and an increasing number of more expensive procedures seem like common yet subtle responses to Medicare's efforts to manage by price. Medicare claims that hospitals and other institutions actually lose money — an average of 4.5 percent of their reimbursements — on services provided to Medicare beneficiaries and have suffered such losses every year since 2003. Yet the number of hospitals taking Medicare patients has grown in every one of those years. Why? And what explains all those ads targeting Medicare and Medicaid beneficiaries if those programs are such tough customers?

Brill referred several times in his Time article to the "protection" Medicare offers its beneficiaries from high prices. But the massive expansion of care unleashed by Medicare's perverse incentives means that just the tiny sliver of care paid directly by seniors — at the low prices established by Medicare — now accounts for a higher share of their income than before Medicare existed.

Single-payer advocates contend that other nations have managed to better control health-care spending — volumes and prices — by enforcing a true budget for cost. But any review of how our Medicare system actually works illustrates why a single-payer system would be so difficult here: Our government has a pervasive inability to say "no." Only in the United States is public health care an unbudgeted entitlement: Our government promises to pay for any care seniors need and providers respond by relentlessly expanding the definition of need. It's no coincidence.

Medicare is a major source of votes and campaign contributions, both of which reinforce our politicians' unwillingness to address exploding volumes. The program's low administrative costs aren't an accomplishment; they're a refusal to discipline excess care, even dangerous care. The program's low prices are a mirage. As any businessperson knows, with enough market power — not to mention political power — you can always make it up in volume.

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