

The Distended Public Sector

by David Boaz

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The United States has the highest quality health care in the world. At no previous time in history, and in no other country in the world, have we been able to cure as many people of as many injuries and diseases.

Our medical triumphs have had many side effects, one of the most obvious of which is rising costs. Medical costs have increased for a variety of reasons, including new technology and our ability to keep very sick people alive much longer.

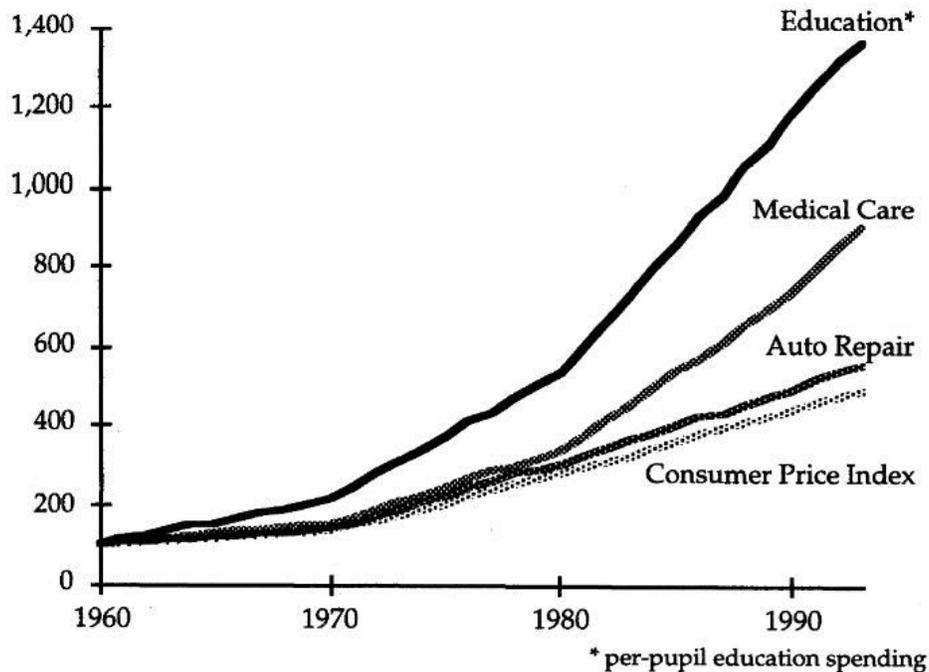
Another reason for rising health care costs was identified in 1966 by economists William J. Baumol and William G. Bowen. They called it "the cost disease of the personal services," but most economists call it Baumol's disease. The thesis that productivity in personal services does not improve has recently been forcefully advanced in the health care debate by Sen. Daniel Patrick Moynihan, who argues, "Productivity in most sectors has improved dramatically in the past 200 years, but not in jobs such as the arts, teaching, law and health care, which require a high level of personal input."

He offers a persuasive example of how personal services resist productivity improvement: "In 1793 to 'produce' a Mozart quartet required four persons, four stringed instruments, and, say, 35 minutes. To produce a Mozart quartet today requires--four persons, four stringed instruments, 35 minutes."

Yet many more of us can hear a Mozart quartet today than in 1793. Why? In 1793 perhaps a few hundred people could hear each performance, and it was difficult and expensive for the players to move on to the next town where several hundred more people might gather. Today, however, the musicians can travel by bus, train, or airplane and reach many more audiences. Even more dramatically, the performance can be broadcast over radio and television to reach millions of listeners at once. Or it can be recorded and distributed worldwide on

records, tapes, or compact discs. Thus, despite the apparent lack of any change in musical productivity, people today have the output of dozens of musical groups at their fingertips.

Price Trends: Health Care and Other Services vs the CPI (1960=100)



Moynihan identifies a number of services afflicted with Baumol's disease: "The services in question, which I call The Stagnant Services, included, most notably, health care, education, legal services, welfare programs for the poor, postal service, police protection, sanitation services, repair services . . . and others." He points out that many of those are provided by government and posits that "activities with cost disease migrate to the public sector."

But maybe he has it backwards. Maybe activities that migrate to the public sector become afflicted with cost disease. The conservative magazine *National Review*, which, surprisingly, seems to accept Moynihan's thesis, has inadvertently supplied us with some evidence on this point.

Ed Rubinstein, *National Review's* economic analyst, writes, "For more than three decades health-care spending has grown faster than national income. . . . The trend in health-care costs is

no different from that of other services." He cites education and auto repair as examples.

However, the numbers Rubinstein provides don't support his--or Moynihan's--point. Look at the accompanying figure.

The cost of auto repair, a service provided almost entirely in the private sector, has barely outpaced inflation. The cost of medical care increased twice as fast as inflation. Government's share of medical spending increased from 33 percent in 1960, when the chart begins, to 53 percent in 1990. Meanwhile, the cost of education, almost entirely provided by government, increased three times as fast as inflation--despite the constant complaints about underfunded schools.

The lesson is clear: Services provided by government are afflicted with Baumol's disease in spades. Services provided in the private sector, where people spend their own money, are much less likely to soar in cost.

Medical care is a good area in which to test this theory because over the past 30 years it has been paid for in three different ways: out-of-pocket spending by consumers; insurance payments, mostly provided by employers; and government payments. As out-of-pocket spending declines in importance, medical inflation heats up. And private-sector spending on medical care rose only 1.3 percent a year between 1960 and 1990, while government spending rose more than three times as fast--4.3 percent a year.

When services are provided privately, and consumers can decide whether to purchase them, or choose another provider, or do without, there's a powerful incentive to improve productivity and keep costs down. Stagnant productivity in government-run services reflects not so much Baumol's disease as what we might call Clinton's disease, the notion--even now, in 1994--that government can provide services more efficiently and cost-effectively than can the marketplace.

Senator Moynihan says the lesson of all this is that health care costs will keep rising as a percentage of our national income no matter how we pay for medical care. But the evidence

points to a different lesson: people spend their own money more carefully than any senator or bureaucrat. To keep costs down, keep health care in the competitive marketplace.

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