

Don't Blame the Free Market

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By Kris Sayce

We recently wrote advising you to "[Beware Ken Henry's Tax Reforms.](#)" Among our arguments was an attempt to discredit the idea that higher rates of tax help the poor.

We pointed out that it does no such thing. In fact, the notion that taxation helps to redistribute wealth from the rich to the poor just isn't true. Aside from the immoral practice of government's forcibly taking private property (part of your income) from you, is the false idea that this money is given to the poor.

It isn't. The money is taken by the government and spent at its whim. Invariably it's wasted money as governments inevitably pay higher prices for goods and services than what is paid by the private sector.

The reason for this is simple. Government's and public sector organizations do not have to operate on a for-profit basis. When a business enters into a transaction they do so based on whether they believe the transaction will be profitable.

Government departments have no such worries. They are provided with a budget of \$X million and are free to spend up to that amount. They do not have to consider whether they will make money from the transaction.

If they need more money, they ask the Treasury for more, and if the Treasury is willing, it will allocate more money to them. Equally, the Treasury knows it does not have to weigh up the profitability of the transaction as it knows it can raid taxpayers pockets for more money through higher taxes or higher public debt.

In other words, there is no profit motive.

In the above mentioned article we questioned how it was possible for health spending to be ever more expensive, yet products that are subjected to market influences - such as technology - gets cheaper over time.

In response, Money Morning reader Nanette posted this comment on the Money Morning website:

"I completely disagree with you in regards to the health care system. Yes there is a tremendous amount of money waisted [sic] - mainly in the managment/middle management section and yes the private hospitals run many times more efficiently than the public ones, but we do not want a health care system than runs as a free market if it looks anything like the USA health care system. I don't know what the answer is but at the moment every person in Australia has access to health care and if the condition needs urgent attention then it is seen to straight away. I do agree that the system needs major improvement and needs to be much more efficient."

[Ed note: you can post your comments too on www.moneymorning.com.au]

The US health system is frequently used as the reason to argue against a private health system. Heck, Michael Moore made an entire film about how terrible the "free market" US

system was in comparison to the wonderful public systems in the UK and Cuba.

How can we argue with that? Well, one way is to clear up a common myth. In actual fact, the United States does not have a 'free market' health system.

It's a little known fact, but government and non-profit hospitals make up over 80% of the hospital system in the United States. Private sector for-profit hospitals only account for about 15% of the market.

Therefore it's not correct to claim the US hospital system is dominated by the 'free market.' Nothing could be further from the truth. In fact, during the time that the free market has been blamed for the spiraling healthcare costs in the US, the private sector's market share has actually declined.

In 1928, both non-profit and for-profit hospitals comprised around 44% each of the market. The remaining slack was taken by government funded hospitals. Over the next eighty years, the non-profit share of the market has almost doubled whereas the for-profit market share has more than halved.

So, just as the 'free market' was not to blame for the recent problems in global financial markets, the 'free market' is not to blame for spiraling healthcare costs both here and in the US.

In fact, it is the presence of government that creates the distortions and leads to higher prices.

If you look at a comparison of Australian and US healthcare, they are far more similar than conventional wisdom tells us.

Both have a 'closed shop' for key employees - doctors. And both have a system of forced health insurance. Both of which serve to ensure that prices will only ever go in one direction - and that's up.

First the closed shop. Unless a surgeon or doctor is approved by the various doctor's 'unions' then you can't get a job as a surgeon or a doctor. Naturally the argument is put forward that this is crucial because it is dealing with people's lives.

In reality, that's just an excuse put forward by the doctor's unions. In a genuine free market, hospitals would compete with each other for patients and for staff. The hospital would set its own requirements on whether a doctor was sufficiently qualified.

Of course, a hospital isn't going to hire a taxi driver or a financial newsletter editor to fill the role of a surgeon. It will hire someone it believes is capable of doing the job.

Doctors applying for the job will price their services based on a true market rate. If they set their fees too high they risk losing out to other doctors. The consequence is that prices will be pushed down as doctors look to take advantage of competitive pricing.

Another factor that pushes up prices is compulsory healthcare contributions. In Australia we have the Medicare Levy, plus the Medicare Levy Surcharge and 'compulsory' private health insurance.

Of course, technically private health insurance isn't compulsory, but in practice it is. Because once you earn above a certain level the Medicare Levy Surcharge kicks in, so you may as well pay the private insurance to get your own healthcare rather than the government variety.

The result is the healthcare industry has a guaranteed revenue stream every year. It does not have to concern itself with keeping within a budget as they know they will get \$X billion each and every year.

The suppliers to the healthcare industry know this as well, hence the massive sales forces they employ. Which hospital doesn't want to have the latest and best machinery? And when you don't have to worry about making a profit, you can just buy it as long as the money is within the budget.

The US market is similar, except that employees tend to belong to a company healthcare programme. Why? For the simple reason that health insurance premiums are deducted pre-tax. Therefore there's the incentive for employees to take the employer-provided healthcare rather than pay for it in after-tax dollars.

In addition, in the US, the non-profit hospitals get tax-breaks the private hospitals don't get. Such as concessions on property, sales and income taxes. This puts them at a competitive advantage to the private sector. But rather than pushing costs down, as with all distortions it actually pushes costs and prices up.

But it's only going to get worse. If US President Obama's universal healthcare proposals are adopted it will lead to higher health costs in the US and here in Australia.

It may be the politically incorrect argument to suggest that healthcare costs are high due to government interference, but once you strip away the emotion and myths, the facts clearly show that healthcare costs are high and the quality of service low precisely because of government interference.

Cheers.

Kris.