Policy Memo

How Higher Hospital Costs Lead to Higher Prices

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Introduction

The healthcare sector now represents nearly one-fifth of the U.S. economy—and the price for healthcare continues to rise. A recent **Harvard-Harris poll** shows that price increases and inflation are the top co-issues for voters. A **Kaiser Family Foundation poll** in late February showed that almost 75 percent of adults "worried about being able to afford unexpected medical bills… and the cost of health care services," while about half said that "health care costs are a major reason for their negative views of the economy." Unfortunately, hospitals have taken advantage of misguided government mandates and market consolidation and, according to the U.S. Department of Health and Human Services, are now the most significant driver of rising medical prices, accounting for **30 percent** of all healthcare spending. Retail drugs, by comparison, account for only **nine percent**. As the American population ages and demand for health services increases, healthcare prices are more likely to rise than fall. To help reduce medical expenses, hospitals—and the policymakers that help oversee them—should look for ways to control spending and alleviate known causes of higher costs.

How to Reduce Hospital Costs

One reason hospitals can charge insurers and patients exorbitant prices stems from a lack of market competition. Hospital consolidation has reduced the number of hospitals that must price their services competitively, which insulates pricing from competition. And hospitals have acquired private physician groups, bringing them in-house, as another way to limit competitors. Demand for healthcare rises, but the number of care providers declines, allowing the remaining consolidated providers to charge higher rates. In communities with less than four competing hospitals, **like Columbus**, for example, hospital prices are **significantly higher**. Thus, adding hospitals and making the healthcare market more competitive with more competitors will help lower costs and reduce **patient mortality rates**.

Hospital prices also continue to rise simply due to excessive spending and over-expansion. New spending is needed, of course, to take advantage of medical innovations, update old equipment, and refurbish hospital infrastructure. But even though hospital occupancy has declined for 40 years and more than a third of all hospital beds are **unoccupied**, hospital systems continue to expand their facilities—with a bevy of luxuries and **modern amenities** designed to boost demand—and that expansion and those amenities invariably prove expensive. The Ohio State University, for example, has begun a nearly **$2 billion** expansion of its Wexner Medical Center with more than 800 new beds. Some healthcare experts **question** whether a larger inpatient facility is needed given the rise of telemedicine and outpatient care, but those doubts have not stopped Ohio State from pursuing its **largest** capital project ever. Although the university has announced some fundraising, much of the project will require additional **debt**. And debt must eventually be repaid—with interest. Taking on new debt in an era of high interest rates means that the hospital will need to raise revenue to make those payments, which means raising prices for patients, insurers, and taxpayers.

In sum, hospitals ultimately pass along their capital costs to patients, employers and taxpayers. A recent **RAND study** found that Ohio hospitals already charge commercial insurers 276.62 percent of what they charge Medicare for the same services, and the Congressional Budget Office found that rising costs get **passed on to commercial insurers** which "may lead to higher premiums, greater-cost sharing requirements for patients, reductions in the scope of benefits, or other adjustments to plans." The bigger, more luxurious, and more expensive the facility, the higher costs will rise, and the more plans will need to be adjusted. Patients will face higher premiums and employers will adjust their healthcare plans as hospital prices escalate, all while amenity-filled hospitals never demonstrate or deliver **higher quality care**.

Conclusion

To improve the quality of care and reduce the prices charged for it, policymakers should seek ways to make healthcare providers more competitive by increasing the number of market competitors. And given the oversized role that hospitals play in rising medical costs, hospital expansion and overpriced amenities should submit to stricter cost-benefit analyses to ensure that the inevitable expenses incurred and passed along will be worth the price the patients will be made to pay.