Should the PSC set hospital prices?

by Commissioner Roger Koopman

After serving two terms in the Montana State House of Representatives, I recall observing one day, "If there was a civil penalty connected with violating the laws of economics, most legislators on both sides of the aisle would be facing life sentences." House Bill 395, which would commandeer the powers of the Public Service Commission to clamp price controls on Montanan's hospitals, is a classic example of how lawmakers become lawbreakers when they cannot separate good intentions from bad economics.

The alarming cost of healthcare across our state and nation is a constant and vexing concern to all of us. As medical costs rise, so do the premiums we pay for our health insurance. Bozeman Representative Tom Woods thinks he has a solution, but his bill would fix healthcare costs about like arsenic would cure a sick patient. While Woods can be commended for wanting to address the problem, HB 395, by focusing on symptoms rather than causes, would do far more harm than good.

HB 395 is grounded in the belief that if prices are too high, all it takes is for the government to impose arbitrary limits and all prices will become affordable and "fair" again. It is what I call The Magic Wand School of Economics, and if has a great many dedicated devotees. Yet if all it took was a government decree to give us the prices we're happy with, why not have specialized government bureaus setting all prices across our economy? Logically and instinctively, we know that makes no sense.

It would be a different situation, if the sixty-one hospitals this bill regulates were natural monopolies, where there was no opportunity for customer choice and price competition. The utilities the PSC regulates clearly fall into that category, requiring rigorous rate-regulation. But by no stretch can these hospitals, let alone the hundreds of clinics and other providers with which they compete, be thought of as monopolies and public utilities.

HB 395 would call upon the Public Service Commission – whose primary mission and expertise is the regulation of energy monopolies and other public utilities – to double its staff, double its budget, and begin regulating and enforcing the maximum allowable prices charged by all of the state's sixty-one hospitals – a responsibility none of the other forty-nine states have assigned to their PSCs.

At a time when state government must put itself on a much-needed diet, the Woods legislation would result, according to the fiscal note (conservatively comparing us with the $12 million budget of Maryland's Healthcare Commission) in new expenditures exceeding $3.5 million -- a figure that doesn't take into account numerous uncalculated costs. Where is this new money supposed to come from? Another line item on our power bills perhaps?

Logistically, it would be extremely difficult, if not impossible, to recruit, train and develop within the Public Service Commission, the kind of functional expertise envisioned in this bill. How would we find these people? What new office space would we need to build or rent? How much would we need to pay them to get them to move to Montana? How much contracted consulting assistance would we need for how many years, just to satisfy the minimum requirements of the new law? What kind of all-new IT system would be need to create, for at least hundreds of thousands of dollars more? How many other unforeseen expenses and problems lie ahead?

Moreover, the prospect of transforming the PSC into a two-headed bureaucracy with two distinctly different missions is mind-boggling. The PSC is tasked with the incredibly important job of regulating public utilities. That job must never be compromised, divided or diminished. Yet how could a bifurcated commission – elected for its knowledge and competence in utility regulation – somehow become experts in healthcare as well? How much will this major distraction from our core mission compromise our ability to protect the long-term interests of rate-payers? How many millions might be added to consumers' energy bills, while we debate the cost of MRIs?

But the single overriding reason for rejecting Rep. Woods' legislation is that it poses a political "solution" with no economic eyes through which to view the long-term consequences. It is a classic example of regulation that is trying to fix a problem without first identifying the cause.

The problem is not price. The problem is the **causes** of price. If you don't get at the causes, you'll never get at the solutions. That's why economists will tell us that price controls never work. Free economies do not function in a top-down, government command fashion. They are markets, driven by consumers. Pricing plays a vital role in a free economy, signaling when to produce more, when to produce less, when to innovate, etc. You can't put a blanket of price controls over an industry and think you've created a solution. You've only created a worse problem.

In the long run, price controls always create scarcity, because they reduce the incentive to produce. Rent control is a perfect example of this, where capping rent results in far fewer rentals being built or properly maintained. The root causes of the costly rental prices are never addressed, and typically, the next "solution" becomes subsidies followed by government-owned housing. Scarcity of housing is the direct result of prices being artificially depressed, while the conditions leading to the high rents in the first place remain unsolved.

Scarcity, rationing and subsidy are the <u>last</u> things we want for healthcare in Montana! We need to encourage, not discourage the development and expansion of quality, cost-effective healthcare services in our state, that will provide more market choice, greater price transparency, and real consumer empowerment. HB 395 would do the exact opposite of this, and would likely render Montana the most hostile and unfriendly place for health providers in the nation.

The causes of out-of-control medical costs are many, and cannot be addressed in this brief commentary. But suffice it to say, they have everything to do with healthcare not functioning as a normal market. Government regulations and mandates drive up costs tremendously, while government policies effectively reduce consumer choice and pander to inefficiency. Tort reform to address the enormous pass-through costs of medical liability remains stymied. Price transparency, combined with insurance policies that offer real incentives (rebates and lower premiums) for customer-generated savings, are just one example of a promising long-term solution, that preserves freedom and spurs competition.

Throughout the bill's hearing, the sponsor and his party faithful repeatedly asserted, "Well, we've got to do something!" -- as if the sky was going to fall tomorrow morning. Beware of legislators who driven by that simplistic mentality. Like lemmings in panic mode, they will drive us right over the cliff. When it come to passing legislation, you simply cannot violate the laws of economics without paying the price. Sincerity and good intentions are not enough.

Koopman is serving his second term on the Public Service Commission, representing PSC District 3. A 37-year small businessman, he also served two terms in the Montana State House of Representatives, from 2005-2008.