# The Necessity of Free-Market Prices for Medical Care

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**ABSTRACT**

The free market is said to have failed in American medicine. However, a free market has not existed in American medicine for more than half a century, and many features attributed to the "market," even in economics textbooks or treatises by medical organizations, are in fact characteristic of government-managed markets.

A transparent price mechanism is critical for restoring the free market, protecting liberty, and assuring the availability and quality of medical services.

## How American Medical Payment Arrangements Differ from a Free Market

A free market may be defined as the sum of those voluntary exchanges that furnish mutual benefit to participating individuals. Virtually innumerable positive-sum games occur in a genuinely free market: i.e. both parties are better off as a result of a trade,[1] as of money for medical care. In such a market, neither medical services or medical insurance could be "too costly" because free-market prices spontaneously and rationally allocate available resources while constraining market participants to live within their means. Inflation, correctly defined, does not occur in the absence of fiat money.

Government intervention in the form of price controls and the creation of fiat money (the U.S. dollar) works to inhibit or preclude mutually beneficial exchanges.

The interposition of an insurer between patient and physician also interferes with the mutual benefit of a direct free-market transaction. A situation in which physicians feel that they are forced to contract with third parties rather than patients cannot be a free market. If contracts between physicians and third parties were mutually beneficial, both parties would gain from treating the sick. This is obviously not the case. The insurer always experiences a loss when a claim is submitted; it benefits only from payment of premiums, not from receiving a medical service. Thus, contracts between physicians or facilities and third parties are anomalous by nature. Such an arrangement gives third parties the incentive to pressure medical professionals to curtail medical interventions regardless of the best interest of the patients.

## How Should Limited Resources Be Allocated?

Economics is a science that studies that aspect of human action dealing with the problem of scarcity,[2] a universal human condition. Because of scarcity, choices and trade-offs are necessary. The question is how to allocate scarce resources most efficiently.

For the sake of simplicity, it is useful to contrast two systems, pure capitalism and pure central planning.[3] These two competing theories can best be grasped by determining how each one generates prices.

One theory maintains that functional knowledge transmitting prices can be discovered if resources are publicly controlled. This control can be either de jure or de facto. An example of de jure control is the U.S. Postal Service. An example of de facto government control is a physician's office. The other competing economic theory favors legally protected resources controlled by individuals (i.e. private property rights that are scrupulously respected by all economic actors including government). In other words, both economic paradigms maintain that prices are necessary to deal with the problem of scarcity but differ as to the mechanism whereby prices are generated.

The public property theory based on central planning asserts that "experts" in government can gain the vast knowledge required to dictate those prices that will efficiently allocate goods, including medical products and services. This theory, which presupposes virtual omniscience in a select few, stands in stark contrast to the modest free-market theory, which posits that knowledge about resources is radically dispersed amongst billions of individuals.[4]

The consequence of the free-market theory is that all these individuals should be empowered to use their unique knowledge in order to discover the most valued use of resources. This is accomplished by consensual trades to generate prices. These real knowledge-transmitting prices are then utilized to guide the choices individual economic actors must make when communicating their preferences about resource allocation each time they make an economic transaction.

The free-market haggling process, which can instantly generate changes in prices (for example, the price of stocks changes quickly, reflecting new knowledge), is the only way to convey the rapid informational changes characterizing dynamic, free economies.

Those who espouse free markets readily admit that they do not possess the knowledge required to dictate what percentage of a country's wealth should be allocated to medical care, education, transportation, leisure, etc. But, they do confer a presumption of competence to individuals to employ their unique knowledge of local conditions and their own needs and values when choosing which trade-offs to make.

The alternative is to have government officials set priorities for resource use by asking it to pull nugatory prices out of a hat. Let us assume for the sake of argument that government could obtain the required dynamic knowledge to set functional prices. It would still be faced with another insurmountable problem, namely, the politics of theft. Under government central planning each and every one of us is spurred to plead with government to fix prices for our benefit, at the expense of others. This pleading or lobbying triggers a war of all against all in which everyone ultimately loses because lobbying circumvents mutually beneficial exchanges (in which everybody wins) and engenders the deadweight costs associated with unproductive government intervention.[5]

Vast amounts of resources are wasted in the lobbying process itself, then by the overhead of regulatory agencies, and also by professionals such as accountants and lawyers retained by citizens and industry to avoid and resist the takings. The wealth squandered in attempts to influence central planning to advantage some at the expense of others or to avoid being disadvantaged could, in a genuine free market, be channeled to consumption, wealth creation, and charity.

Thus, there are two types of prices: genuine market prices determined by billions of individual decisions, or government-set pseudo-prices. The latter result in misallocation of resources and effort, and promote corruption at all levels.

**The Effect of Abolishing Prices**

Government pseudo-prices have created havoc for the suppliers of medical care at the macro and micro level. The problem is compounded when demanders (patients) are not directly affected by prices at all. Third parties including government have duped patients into believing that medical care is a free good. The predictable result is that patients, in concert with doctors, have adopted consumption behaviors that allocate inordinate amounts of resources to medical care at the expense of future generations, education, food, defense, and all other needs.

This resource misallocation cannot be sustained. Something must be done, but what?

It is politically impossible for government to accept the blame for the economic chaos it created with legislation decreeing that a scarce good, limitlessly demanded, would be limitlessly supplied. Instead, government brazenly demonizes the suppliers of the "free" good, doctors, hospitals, drug manufacturers, and others, in order to justify regimentation ("regulation").

Needless to say, the demanders (i.e. patients), whose votes are needed to perpetuate the hoax, can neither be blamed nor directly regimented. As a practical matter, government has no other option but to limit supply by rescinding the liberty of the suppliers. Physicians are ignominiously reminded of that fact by managed care, which places them at financial risk for supplying medical care (the antithesis of free markets), by incomprehensible coding and documentation directives, by limited fees that do not cover costs, by the deadweight costs of bureaucratese, and increasingly numerous other hassle factors. But that is not enough. Government has discovered that bureaucratic requirements do not adequately curtail supply. Its next predictable step is to criminalize the medical profession in order to further limit the supply of medical care.[6]

Unjust laws provide incentives to aggressive prosecutors to incarcerate doctors for picayune, undecipherable bureaucratic rules. Jailing physicians guarantees an absolute diminution in the supply of medical care; moreover, it impels their peers to assiduously obey government edicts prior to treating the sick. Obeisance supersedes patient care. Or to paraphrase Trotsky, one must obey before one is permitted to eat.

Government-created negative incentives not only discourage the supply of known medical cures but also curb future medical miracles brought to us by entrepreneurs. Arguably, these inimical government interventions are the most effective way to limit the supply of innovative medical care.

**How Free-Market Prices Work**

The salutary, harmonizing function of real prices is neatly summarized by the phrase coined by Randy Barnett in the context of criminal law: "to compensate for a reduced rate of capture."[4]

A genuine pricing system not only fosters harmonious competition for scarce resources, but also serves to capture, to monitor, and to stop uneconomic trades (i.e. trades which are not mutually beneficial). The use of prices to stop patently uneconomic trades is easily understood: no competent person pays \$1,000 for a \$10 good. But the use of prices to reveal genuine consumer preferences and rationally allocate resources requires further comment.

Let us assume that patients carry real insurance that only pays for costly, unpredictable medical interventions after deductibles are met. (Such insurance is rare in the U.S. today.) How many patients would elect to undergo cataract or joint replacement surgery for borderline indications, instead of spending that deductible on other scarce goods such as travel? Absent real prices, there is no way to know. Patients will often choose both goods if one of them (i.e. surgery) is perceived to be free. But consuming scarce goods as if they are free causes economic chaos. Because government has eliminated the monitoring function of prices, it must compensate by setting up a substitute system in an attempt to control profligate consumption. This surrogate monitoring system is known to all doctors as managed care, coding, audits for "fraud and abuse" (including the provision of "medically unnecessary" services), and most ominously, as the criminalization of medicine.

The cost of abrogating free-market prices includes preventing one of the most educated segments of society from fully using its knowledge to improve the lives of patients.

**Regression from Wealth to Poverty: An Example from History**

Because a purely theoretical exposition of the benefits of a free market may not be convincing, a brief digression into history is offered.

In 960 A.D. the Chinese emperor Sung Taizu instituted a dynasty that embraced many free-market principles.[7] These free-market provisions included the rule of law, free speech, tradable property rights, and a stable monetary system. Sung's policies produced dramatic results: a free market in land; free movement of goods and labor; and impressive growth of agriculture, trade, and manufacturing. For example, in 1078 China produced 125,000 tons of cast iron, an accomplishment not surpassed until England did it in the 1790s.

Additionally, China made a whole range of technological breakthroughs: type printing, paddle-wheel ships, the magnetic compass, and seaworthy vessels carrying up to 600 tons manned by 1,200 sailors.

But during the next millennium, the Chinese regressed to third-world status. A crisis occurred and was seized upon by a new dynasty as a pretext to implement government central planning. Under the Sung dynasty, China was invaded and largely destroyed by the Mongols (1268 to 1279). The Chinese regained control of their territory in 1371 under the Ming Dynasty, which blamed the Sung laissez-faire policies for China's defeat. In response, the Ming reintroduced central planning, with loss of private property in land, forced repopulation of Northern China, cessation of foreign trade, and destruction of technologies (all ship building became illegal). The predictable, unfortunate result is known to all. Over the course of the next 1,000 years China regressed from the most successful society on the planet to an impoverished status from which it has yet to recover.

**Conclusions**

The lesson to be learnt is always the same. Societies that reject the principle of liberty, which requires legal protection of private property and its use in exchange to generate prices, risk stagnation or regression. The implications for medicine are obvious. If the central planning policies hobbling medical care are not reversed, it may succumb to the Chinese scourge.

No one except the individual patient and physician should profess to know the value of a medical service or a physician's skills. Nor should anyone presume to know how much of a country's wealth should be allocated to medical care. To assist the government in implementing central planning and price controls only helps to perpetuate and enhance the credibility of these destructive interventions.

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