JOINT ECONOMIC COMMITTEE

Senator Sam Brownback, Ranking Republican

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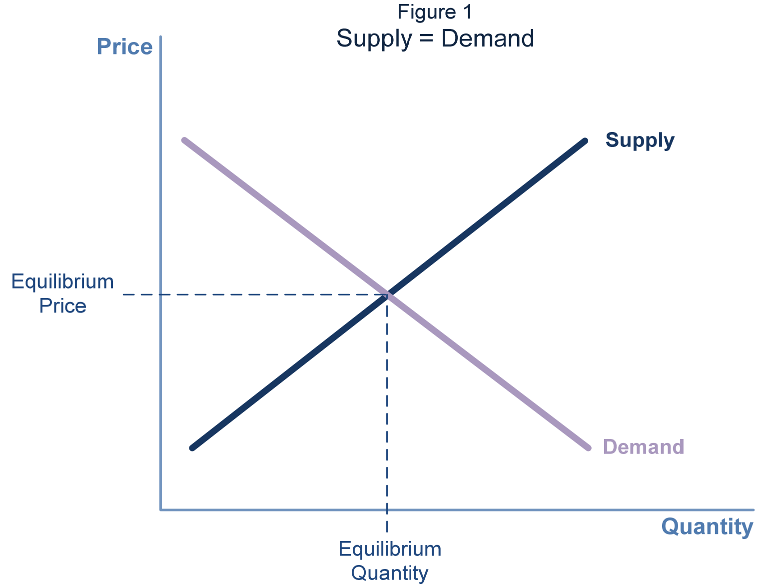
Health Care Reform Legislation Meets Economic Reality

The Law of Supply and Demand is immutable – Congress and the President lack the power to change it.

The Law of Supply and Demand states that as prices increase, the quantity demanded of a good or service decreases, and, on the other hand, as prices increase, the quantity supplied of a good or service increases (figure 1). Where the quantity demanded (purple line) and quantity supplied (blue line) meet is the equilibrium—at this price, the amount suppliers are willing to produce is exactly equal to the amount consumers are willing to buy.

Figure 1
Supply = Demand

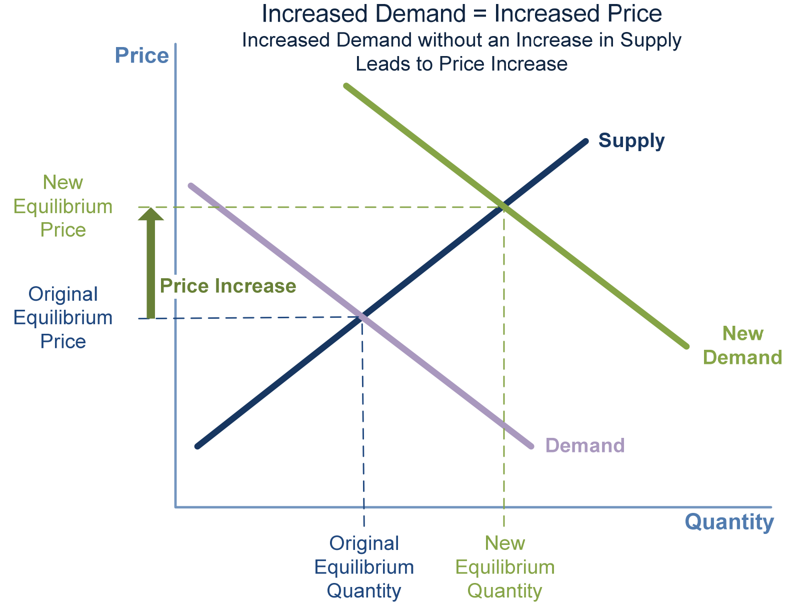


Increased Demand without Increased Supply = Price Increases or Rationing

Health care reform legislation under consideration in both the House and Senate seeks to increase the availability and affordability of health insurance to all U.S residents. Dramatically expanding health insurance coverage in the fashion contemplated by legislation pending in both chambers of Congress would translate into significantly higher demand for health care goods and services in the United States.

Unfortunately, the proposed legislation fails to address the issue of Supply. While the U.S. enjoys some of the greatest access to care

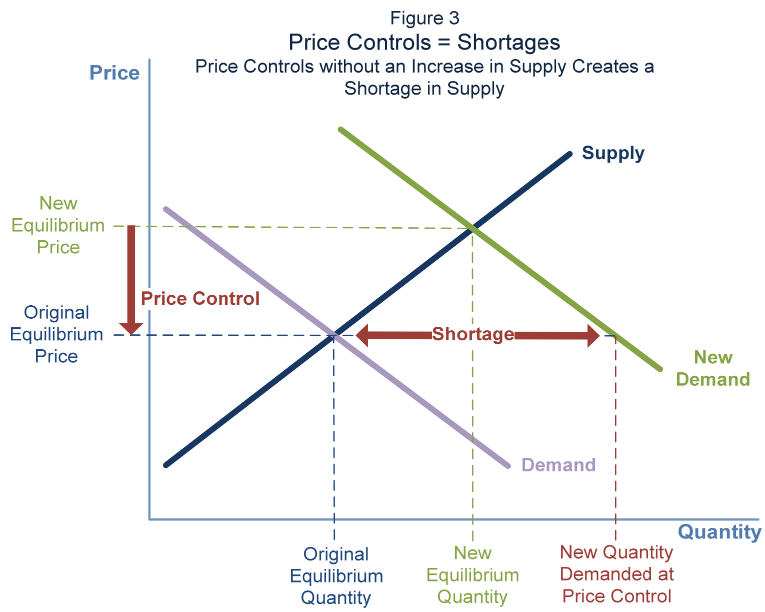
Figure 2
Increased Demand = Increased Price
Increased Demand without an Increase in Supply
Leads to Price Increase



and lowest wait times in the world, a massive increase in the Supply of health care (doctors, nurses, medicine, machines, etc.) would be necessary to match the massive increase in demand. Without an equal increase in Supply to match the new Demand, prices would significantly increase (figure 2).

Proponents of the legislation argue that the plan will limit the growth of health care prices – "bend the cost curve" – by reducing the rate of growth in medical care costs. But as figure 2 shows, the natural result of an increase in demand is an increase in price.

The only ways to counter this effect and keep costs down without an increase in supply would be to impose price controls (figure 3) or to limit demand by restricting access to health care services.



However, not allowing prices to increase with the rise in demand will lead to shortages (and also create a disincentive for increasing supply). At current prices, medical providers are only willing and able to supply the current level of care and products. Increasing demand at current prices only further limits the availability of care and products. If demand rises, and providers are not allowed to increase prices, rationing (either by providers or by the government) will be necessary to determine who gets care.

If Not Price Controls or Rationing, What Then?

If, as proponents of currently proposed health care reform bills imply, the government expansion of health insurance coverage will neither lead to price controls or rationing, how will the market for health insurance reach a new equilibrium? One possibility, which those proponents are reluctant to acknowledge, is that their proposed legislation would significantly drive up the price of health care, which would in turn, reduce demand to a level where supply could cope with the new influx of the previously uninsured.

The Joint Committee on Taxation has estimated that the proposed fees on health insurers, drugs, and medical devices will increase the prices of those products and services. In addition, the high cost plans tax proposed by the Senate Finance Committee will increase the effective price of health care to individuals and families by subjecting an increasing portion of medical expenses to income and payroll taxes. These increased costs for consumers of health care will limit the amount (demand) of health care that individuals and families can afford. What remains to be seen, however, is whether or not the resulting price increases will be large enough to accommodate the new demand without government price controls or rationing.