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RESEARCH SUMMARY

CAN HEALTH SPENDING BE REINED IN THROUGH SUPPLY CONSTRAINTS?
An Evaluation of Certificate-of-Need Laws

Certificate-of-need (CON) laws are among the various experiments policymakers have conducted in an effort to curb the growth of healthcare spending. Currently in place in 35 states, these laws require new or expanding healthcare providers to prove to their state government that they are economically necessary and that they effectively limit the supply of healthcare services.

In a new study for the Mercatus Center at George Mason University, "Can Health Spending Be Reined In through Supply Constraints? An Evaluation of Certificate-of-Need Laws," economist James Bailey finds that CON laws may actually increase healthcare spending, while states that have repealed these laws show a decrease in spending.

BACKGROUND

New York was the first state to institute a CON law in 1964. Pushed by the National Health Planning and Resource Development Act of 1974, every state except Louisiana had a CON program by 1980. These laws require a certificate to be issued by a state regulatory board before a hospital or healthcare provider can open or expand. State bureaucrats determine which services or facilities are "needed" and thus allowed.

CON laws were intended to promote equal access to health care and to control costs by preventing redundant healthcare services and encouraging providers to offer more indigent care. For example, CON laws can restrict new suburban or specialty hospitals, thereby protecting urban and rural facilities that serve poorer patients.

The federal push for CON laws slowed in the 1980s, and since then, fifteen states have repealed their CON laws. These repeals allow for comparisons in healthcare spending between states with and without CON requirements.

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METHODOLOGY

The study uses data from the National Health Expenditure Accounts to determine annual healthcare spending in each state. When the data are applied to a simple economic model of supply and demand, the study shows how CON laws impact this spending. The study also breaks down healthcare spending by payer (i.e., Medicaid, Medicare, and private) and healthcare provider type (i.e., hospital, physician, and nursing home) and determines the impact of CON laws on each of these categories.

KEY FINDINGS

CON laws raise total healthcare spending.
Contrary to their intended purpose, CON laws raise overall healthcare spending by 3.1 percent—5.0 percent for physician care. As for type of provider, while CON has little effect on Medicaid spending, it increases overall Medicare spending by 6.9 percent.

- A primary reason for the spending increase rather than decrease is that demand for healthcare services remains virtually steady, while CON laws restrict the supply of health care. Economic theory holds that if supply shrinks and demand remains steady, prices will increase.

- Unsurprisingly, Medicaid saw the smallest spending increases, as it is thought to be the least generous and most price-conscious payer.

Repealing CON laws lowers total healthcare spending.
States that repealed CON laws have seen overall healthcare spending reduced by 0.8 percent per year, leveling out to a 4 percent drop after year five. The greatest decline in spending is with physicians at 1.4 percent per year, compared to a drop of 0.3 percent per year in hospital expenditures.

CON laws can exempt existing providers at the expense of new providers and consumers.
Economic models generally assume a competitive market for goods and services. CON laws, however, may alter the healthcare market by allowing existing hospitals and health facilities to be grandfathered in. This disruption occurs by exempting pre-CON facilities from approval requirements and squeezing out new entrants to the market. In these cases, CON laws help existing providers and special interests at the expense of consumers and society.

CONCLUSION

Certificate-of-need laws have largely failed in their original goal of reducing healthcare spending. In fact, costs are shown to increase in many states with such laws, while states that have repealed CON laws have seen overall healthcare costs fall. Rather than continue the expensive and time-consuming process of CON approval, policymakers looking to slow the growth of healthcare spending should instead repeal all CON laws.