

Book Review: The Cost Disease: Why Computers Get Cheaper and Health Care Doesn't

by Blog Admin

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*The exploding cost of health care is a source of widespread alarm. Similarly, the upward spiral of tuition fees is cause for serious concern. In this concise and illuminating book, economist **William Baumol** explores the causes of these seemingly intractable problems and offers a surprisingly simple explanation. Baumol identifies the 'cost disease' as a major source of rapidly rising costs in service sectors of the economy. Once we understand that disease, he explains, effective responses become apparent. **Edward Larkin** finds Baumol's interpretation of rising health care costs compelling; a must-read for policymakers.*



The Cost Disease: Why Computers Get Cheaper and Health Care Doesn't. William Baumol. Yale University Press. September 2012.

The move last summer from the United States to London prompted mixed emotions. Despite the LSE's reputation as an excellent place to study the social sciences, the UK seemed to lack a certain *panache* as far as policy debates went. Weren't the Brits too civilized for our American psychodramas of protest, the Tea Party and Occupy? What riled these people up?

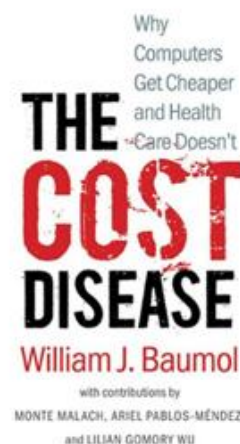
On the plus side, I expected that the furor about health care costs in the UK to be below the perennial fever pitch that it is in the US, where health care accounts for about 18% of GDP. In Britain, health care spending only stands at a comparatively modest 10% of GDP. I looked forward to studying the subject in a monastic environment, where the spectre of "death panels" didn't loom like the Sword of Damocles.

I quickly learned from the front pages of *The Guardian* and *The Times* that the NHS is actually quite contentious indeed. Although we Americans spend far and away the most money per capita on health care, the rate of increase in health care costs is just as high in European countries and Japan.

This seemingly unstoppable rise has prompted many people to theorize on the *why* of the situation. Some blame the spiralling costs on unnecessary care or physician salaries; others on a lack of market discipline due to insurance, or a culture of "defensive medicine" fostered by rapacious personal injury lawyers. All these contribute to health care costs, but they are marginal factors, and often provide no explanation at all on why costs keep increasing as a percent of GDP – that is, consistently increasing faster than everything else we buy.

Cue William Baumol, an American economist whose deliciously fascinating book, *The Cost Disease*, should be required reading for (and I'm aware of the boldness of this claim) all policymakers in the world. Baumol proposed the "Cost Disease" theory in 1966, finally christening it with a book of the same name forty six years later. The idea goes something like this: productivity is increasing in all sectors of the economy, so it takes less time/labor/money to make things. But in some industries, like manufacturing and computing, productivity has increased much faster than in service industries, like health care and education, where the product is "customized" and therefore has an irreducible labor component. Cars can be made by robots, since they are almost completely standardized. However, robots cannot yet perform neurosurgery.

This is straightforward, but the implications are enormous. Since the slow productivity-improving sectors



(what Baumol refers to as the “stagnant sectors”) improve slower than others, they *of course* make up a larger percentage of what we spend money on. Even if health care accounts for 60% of GDP in 2105 (more on this below), that’s fine, because that 40% which buys things from the fast-improving sector (the “progressive sector”) will be able to buy a ton of those things, since they’ve become so much cheaper. Even if health care took up 60% of GDP, it wouldn’t bankrupt us. We will always be able to afford it.

This might seem like a sunny conclusion – the apocalypse is not nigh. But according to Baumol, there is still a significant danger: policymakers *think* that the apocalypse is indeed nigh. As experiences in the US and the UK attest, politicians often take drastic measures to cut health care costs, when in reality, costs don’t necessarily need cutting. Ideally, policymakers would realize that costs are increasing naturally. In trying to solve a problem that’s not a problem, they actually create a problem.

Distributing health care equitably while costs continue to grow is still a major challenge. One of the main lessons from “The Cost Disease” is that since we can and always will afford health care, making sure we have robust income transfer mechanisms in place to help the less fortunate is correspondingly important. This is because despite the fact that the cost disease ensures that we *as a society* will be able to afford more health care, it does not necessarily mean that it will be distributed equitably. Instead of trying to slow the growth of NHS spending in the UK or Medicare in the US, we should be making sure redistribution to poor/ill people is *more* robust.

Perhaps the best thing about Baumol’s book is that it is concise, a rare achievement for a social scientist, a subpopulation that tends to believe its ideas deserve War-and-Peace length tomes. For example, Baumol only spends a few pages discussing how the advances in the “progressive sector” are more dangerous than rising prices in the stagnant sector. When prices fall in areas like weapons manufacturing and individuals gain ever greater power to cause mass destruction, Baumol contests that the fate of humanity itself might be threatened. We might kill ourselves with cost savings. Given the magnitude of this assertion, readers might appreciate a more fleshed-out argument from Baumol.

Although the brevity is laudable, the book could be even more concise, as the last third could be left out altogether. Baumol’s discussion of the evidence and implications of the cost disease is superb. The latter part is a patchwork quilt of essays from Baumol and health services researchers about how to improve business processes in health care. This certainly deserves comment, but it is hardly as inspired as the earlier discussion, and more fitting for one of the legions of “Enterprise 2.0”-ish books that CEOs seem to enjoy for some reason.

I have two editorial objections with Baumol’s seemingly unshakeable conviction that health care will remain in the stagnant sector as far into the future as 2105. First, I can promise that by 2105 “health care” as we know it will be radically different than anything we experience today, and it will probably consist of robots fixing computer viruses for other robots on a lunar colony. Once the irreducible labor component is gone, as it certainly might be in 2105, health care could reap the productivity gains of the progressive sector. Second, while Baumol’s disease certainly contributes greatly to rising health care costs, he spends very little talking about how much of the increase it explains. Most health economists accept as gospel the fact that fast diffusion of new medical technology is the real cause of increasing costs. Since Baumol takes a somewhat contrarian approach, a discussion of how his theory merits a reconsideration of the conventional wisdom is warranted, but it is unfortunately lacking.

Despite the fact that *The Cost Disease* runs out of steam at the end, the first two-thirds are absolutely excellent. Baumol’s interpretation of rising health care costs is compelling, and it is a perspective so rarely heard that every attempt should be made to foist it into the broader dialogue of policymakers, economists, and the public, where it can be analyzed and assessed. As Baumol implies, the real disease lies in our dialogue, not in health care costs.

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