

PRESS RELEASE, OCTOBER 18, 2011

NEW ECIPE STUDY IN HEALTHCARE:

What is Driving the Rise in Healthcare Expenditures?

The last 40 years have seen a rapid increase of government expenditures on public welfare arrangements. Increasing healthcare expenditures form a significant part of these outlays, and its share of total government expenditure has risen rapidly. The next 40 years is likely to witness an even faster expansion of healthcare expenditures in many European countries. In this new paper, economists Fredrik Erixon and Erik van der Marel examine cost drivers in the healthcare sector and discuss methods to increase the efficiency in the use of resources. They conclude that greater specialization and division of labour – in other words, trade and cross-border exchange – is central to a new paradigm to control expenditures in healthcare.

What explains the rapid rise in healthcare expenditures? There has been surprisingly little research focusing at the drivers of healthcare inflation. The consensus has been that increasing expenditures reflect rising incomes and a greater preference among people to consume healthcare services. Yet expenditures have risen much faster than overall economic growth. And healthcare inflation has also been far higher than general inflation. It is therefore unlikely that rising income and changing preferences are the only cost-drivers in healthcare.

Erixon and van der Marel examine various sub-parts of healthcare and cannot find a particular sector that has driven costs more than others. It is sometimes argued that medical technology and pharmaceuticals are the chief cost-drivers, but that is not true. Expenditure on pharmaceuticals has remained at a stable relative share of total healthcare expenditures for a long time – and in a forty-year perspective it has actually shrunk.

The authors argue that the determinants of growth in healthcare expenditure are partly to be found in the way healthcare is organised. As economist William Baumol noted already in the 1960s, personalized services can easily fall into a stagnation trap characterized by rapidly increasing cost inflation. Healthcare today shows clear signs of being a “stagnant personal service” with poor productivity levels compared to other services such as telecommunication. The healthcare sector in several countries shows negative productivity growth.

As a result, healthcare inflation is far higher than the standard inflation rate, creating high real costs that push up the expenditure for healthcare. Consequently, Erixon and van der Marel argue for reforms in the organisation of healthcare provisions to reduce the sector’s productivity lags in European countries and to reap the benefits that emanates from integration with other markets.

Full publication details

What is Driving the Rise in Healthcare Expenditures? An Inquiry into the Nature and the Causes of the Cost Disease, by Fredrik Erixon and Erik van der Marel

ECIPE Working Paper No. 05/2011

About the authors

Fredrik Erixon (fredrik.erixon@ecipe.org), an economist, is the Director and co-founder of ECIPE. He has formerly advised two governments on healthcare reforms and evaluated the effects of hospital reforms. He is the author of several papers on healthcare in the international economy.

Dr. Erik van der Marel is a Research Associate at ECIPE, researcher at Sciences Po and a lecturer at the London School of Economics.

Media enquires

For further information, please contact Fredrik Erixon (fredrik.erixon@ecipe.org) at +32 (0)499 053 107.