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Healthcare's Rent is Too Damn High

By Chuck Dinerstein — February 22, 2019

Courtesy of Kheel Center [1]

Jimmy McMillan [2] might have been right. Not a name that comes readily to mind? Mr. McMillan ran for mayor of New York City as the founder and candidate of the "Rents too damn high Party." And while he was talking about real estate rent, he might have made a similar complaint about healthcare's rent – payments made for costs over what is needed to produce a good or product.

Rent is not a variation on profit, because, in economic terms, profit comes from a human activity that adds value; rent, on the other hand, is "unearned," requiring little or no risk. Rent evolves when an uneven distribution of resources, creates scarcity.

Medical Platforms

Classic economic descriptions of rent referred to land and how after "The Enclosure," when common lands were scooped up and owned by the elite, landlords charge the tenant farmers to use their property.

> *"As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed, and demand a rent even for its natural produce. …[the laborer] must give up to the landlord a portion of what his labour either collects or produces. This portion, or, what comes to the same thing, the price of this portion, constitutes the rent of land ...."*
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> *— Adam Smith: The Wealth of Nations*

Patents, copyrights and "proprietary" algorithms are conventional sources of rent. Today's

landlords are platforms, like Facebook, Twitter, or Apple using their position to extract rent. Electronic health records (EHR) are healthcare's poster child of the rent-seeking platforms with high purchase costs, private practices spend roughly $30-50,000 per physician and a health system, like Kaiser Permanente $4 billion. But then the rent kicks in, maintenance costs, software and hardware upgrades. The high cost of moving and translating all of those records to another system, proprietary algorithms and data structure obstruct the flow of data, make the purchasers an indentured servant to their purchase, creating barriers to competition.

Intuitive Surgical provides robotic platforms for surgery, with over 5,000 "installed platforms" globally. Using the same business model as razor blades, the surgical robots' initial cost, at $1.5 million, is quickly eclipsed by the long purchasing tail – annual maintenance and of course, proprietary instrumentation. According to one calculation [1], those costs at roughly $2400 per operation surpass the purchase cost 2-fold or more. Even in the world of inflated hospital prices, $2400 every time you use the platform to operate, for what amounts to be proprietary maintenance and "disposables" is a significant form of rent.

Medical journals charge rent when requiring payment from authors, allowing them to "produce" work on the "land" they control. They charge rent again to libraries at our Universities to make that platform available to students. The open access movement in publication wants to reduce rent. The University of California is trying to renegotiate its contract for all of Elsevier's journals, a $10 million charge, that doesn't include the nearly $1 million they pay in "preparation fees" for their faculty research to be made freely available. What more appropriately reflects the plantation sensibilities of rent then the lopsided costs of journals; authors provide the materials for free, editorial decisions are made by their peers, often at no costs, and then researchers are charged for preparation, publication, and access. What value is added by the publishers, other than owning the journal?

The cost of pharmaceuticals

Rent often comes from information known only to one party in an exchange allowing them a bargaining advantage. Informational rent thrives in secrecy and "lack of transparency." Every step in pricing medications involve rent, the manufacturers acquire rent through patents while the rest of the supply chain uses their proprietary information. Insurance companies know what medications their beneficiaries need, wholesalers and retailers know what they actually pay for medications, and pharmacy benefit managers are positioned to be privy to all of those numbers. While these players add "value" by lowering the price, the prices would be lower still if the rent they charged was not as great. The "synergy" of merging retailers and health insurers is about rent as much as any announced advantage of scale.

Another classic economic source of rent was the difference in land's fertility. Some ground was just better to grow upon. Today, that form of rent is known by another name, scale – the ability to develop very large. Google, Facebook, Instagram derive their fertility in providing user eyeballs. Health systems are healthcare's version of fertile land. Health systems pay rent to cities in property and labor cost while acquiring dense populations to increase care volume and expertise, creating markets for highly specialized medical care.

These landlords of “brand,” include well-known health systems, Cleveland Clinic, Mayo, Hospital for Special Surgery, and Memorial Sloan Kettering in turn, collect rent affiliating with hospitals outside their geographical “catchment area. Some are tightly integrated, others are mere signage, a halo of quality around a Florida or Arizona hospital and a source of rent for providing a “biosimilar” but not the real deal.

High Demand and Low Supply

There is a rental premium to be paid when demand outstrips supply creating scarcity. In this instance, I reluctantly call out my peers. “Scope of practice” is a form of physician-controlled rent. While we often pose the issue as more education reflecting greater competence, it can act as a barrier to entry. Every physician has a story from their internship when a less “educated” but more “experienced” nurse prevented a mistake or bailed them and their patient out of a jam. Some forms of care can be provided by less trained individuals. We vocally oppose a nurse practitioner or pharmacist reading a rapid strep test and initiate care. We are less vocal and “give a pass” to other physicians in our “club;” isn’t a dermatologist able to treat varicose veins, after all, they appear on the skin?

The scarcity of primary care physicians leads to a rise of concierge practices – accepting insurance payments, co-payments, and charging an additional fee to “belong” in the practice and receive greater access and attention. Those fees become another form of rent when you consider the large companies in this practice space. MDVIP, for example, has over 900 practices, and more than 300,000 patients, owned in turn by its founders, Proctor and Gamble and two different investment firms. What value could an investment firm be adding?

Building a free-standing medical facility is a tradeoff between the substantial cost of building and staffing and the subsequent return – a market-driven barrier to entry. In reducing duplication and assuring accessible, good care, many states require “certificates of need,” approval to build testing and treatment centers; a cumbersome political and bureaucratic process, creating artificial scarcity. To the extent that a certificate of need constrains entrants more than it monitors competence, it acts as another form of economic rent.

If we viewed healthcare costs in terms of rent, we might find other means to reduce our spending. Jimmie McMillan is right, “the rents too damn high.”

[1] Calculations by Dr. Chris Childers, found in of all places a Twitter thread, which you can find beginning here [3] or @childersmd.

Sources: In addition to Dr. Childers, University of California squares off against major publisher, with big stakes for access to research from Stat News [4] and Community Hospitals Link Arms With Prestigious Facilities To Raise Their Profiles from Kaiser Health News [5].

Links
[1] https://www.flickr.com/photos/kheelcenter/5279450638
[2] https://www.youtube.com/watch?v=kcsNbQRU5TI
[3] https://twitter.com/VPrasadMDMPH/status/1093695862973198337
[4] https://www.statnews.com/2018/12/19/university-of-california-squares-off-against-major-publisher-with-big-stakes-for-access-to-research/
[5] https://khn.org/news/community-hospitals-link-arms-with-prestigious-facilities-to-raise-their-profiles/