

The Reason a Facelift Costs Less Than a Knee Replacement

Between 1998 and 2017 prices for “Medical Care Services” in the US (as measured by the BLS’s [CPI for Medical Care Services](#)) more than doubled (+105.3 percent increase) while the CPI for “Hospital and Related Services” ([data here](#)) nearly tripled (+189.3 percent increase). Those increases in the costs of medical-related services compared to only a 50.3 percent increase in overall consumer prices over that period (BLS [data here](#)). On an annual basis, the costs of medical care services in the US have increased almost 4 percent per year since 1998 and the cost of hospital services increased annually by 5.8 percent.

In contrast, overall inflation averaged only 2.2 percent annually over that period. The only consumer product or service that has increased more than medical care services and about the same as hospital costs over the last several decades is [college tuition and fees](#), which have increased nearly 6 percent annually since 1998 for public universities.



One of the reasons that the costs of medical care services in the US have increased more than twice as much as general consumer prices since 1998 is that a large and increasing share of medical costs are paid by third parties (private health insurance, Medicare, Medicaid, Department of Veterans Affairs, etc.) and only a small and shrinking percentage of health care costs are paid out-of-pocket by consumers. According to [government data](#), almost half (47.6 percent) of health care expenditures in 1960 were paid by consumers out-of-pocket and by 2017 that share of expenditures has fallen to only 10.6 percent (see chart above).

Spending Unknown Amounts of Unseen Money

It's no big surprise that overall health care costs have continued to rise over time as the share of third-party payments has risen to almost 90 percent and the out-of-pocket share approaches 10 percent. Consumers of health care have significantly reduced incentives to monitor prices and be cost-conscious buyers of medical and hospital services when they pay only about 10 percent themselves, and the incentives of medical care providers to hold costs down are greatly reduced knowing that their customers aren't paying out of pocket and aren't price sensitive.

How would the market for medical services operate differently if prices were transparent and consumers were paying out-of-pocket for medical procedures in a competitive market? Well, we can look to the \$16 billion US market for elective cosmetic surgery for some answers. In every year since 1997, the [American Society for Aesthetic Plastic Surgery](#) has issued an annual report on cosmetic procedures in the US (both surgical and nonsurgical) that includes the number of procedures, the average cost per procedure (starting in 1998), the total spending per procedure, and the age and gender distribution for each procedure. Here is a link to the [press release](#) for the 2017 report, and the full report is available [here](#).



The table above (click to enlarge) displays the 20 cosmetic procedures that were available in both 1998 and 2017, the average prices for those procedures in each year (in current dollars), the number of each of those procedures performed in those two years, and the percent increase in average price for each procedure between 1998 and 2017. The procedures are ranked by the number of cosmetic procedures last year. Here

are some interesting findings from this year's report and the table above:

- For the top seven most popular cosmetic procedures displayed above for last year, **none of them increased in price since 1998 more than the 50.3 percent increase in overall consumer prices**, meaning that the real, inflation-adjusted price of all ten of those procedures has fallen over the last 19 years. Only four of the 20 cosmetic procedures (facelift, nose surgery, upper arm lift, and chin augmentation) increased more than the overall CPI, while the other 16 procedures increased less than overall consumer prices.
- For three of the most popular nonsurgical procedures in 2017—botox injection, chemical peel and laser hair removal—the nominal prices have either fallen over the last 19 years, by nearly 1 percent for botox (from \$424 to \$420) and by more than 33 percent for chemical peel (from \$821 to \$545), or barely increased (1.1 percent increase in laser hair removal from \$452 to \$457). Note also that the demand for two of those procedures has increased dramatically—botox procedures increased by nearly ten times and laser hair removal by 63 percent.
- The two most popular surgical cosmetic procedures last year were breast augmentation and liposuction, which have increased in current dollar prices by 25.5 percent and 28.0 percent respectively since 1998. Both of those average price increases were roughly half of the 50.3 percent increase in consumer prices over the last 19 years, meaning that the real, inflation-adjusted prices for breast augmentation and liposuction procedures have fallen since 1998—by 17 percent for breast augmentation and by 15 percent for liposuction.
- The unweighted **average price increase between 1998 and 2017 for the 20 cosmetic procedures displayed above was 34.2 percent, which is far below the 50.3 percent increase in consumer prices in general over the last 19**

years. When the average procedure prices are weighted by the number of procedures performed last year, the average price increase since 1998 is only 12.6 percent. Of the 20 procedures above, 16 increased in price by less than overall inflation (and therefore decreased in real terms) since 1998, and only four increased in price by more than inflation (facelift, nose surgery, upper arm lift, and chin augmentation).

- And most importantly, **none of the 20 cosmetic procedures in the table above have increased in price by anywhere close to the 105.3 percent increase in the price of medical care services or the 189.3 percent increase in hospital services since 1998.** The largest cosmetic procedure price increase since 1998 was the nearly 83 percent increase for chin augmentation, which is still far below the more than doubling of prices for medical services overall and nearly three-fold increase in the CPI for hospital services.
- As in previous years, there was a huge gender imbalance for cosmetic procedures in 2017—women accounted for 91.3 percent of the 4.78 million total cosmetic procedures performed last year (92.3 percent of surgical procedures and 90.8 percent of non-surgical procedures).

What Does This Mean?

The competitive market for cosmetic procedures operates differently than the traditional market for health care in important and significant ways. Cosmetic procedures, unlike most medical services, are not usually covered by insurance. Patients paying 100 percent out-of-pocket for elective cosmetic procedures are cost-conscious and have strong incentives to shop around and compare prices at the dozens of competing providers in any large city.

Providers operate in a very competitive market with transparent pricing and therefore have incentives to provide

cosmetic procedures at competitive prices. Those providers are also less burdened and encumbered by the bureaucratic paperwork that is typically involved with the provision of most standard medical care with third-party payments.

Because of the price transparency and market competition that characterizes the market for cosmetic procedures, the prices of most cosmetic procedures have fallen in real terms since 1998, and some non-surgical procedures have even fallen in nominal dollars before adjusting for price changes. In all cases, cosmetic procedures have increased in price by far less than the 105 percent increase in the price of medical care services between 1998 and 2017 and the 189 percent increase in hospital services. In summary, the market for cosmetic surgery operates very much like other competitive markets with the same expected results: falling real prices over time for most cosmetic procedures.

If cosmetic procedures were covered by third-party payers like insurance companies, Medicare, and Medicaid, what would have happened to their prices over time? Basic economics tells us that those prices would have most likely risen at about the same 105.3 percent increase in the prices of medical services in general between 1998 and 2017.

The main economic lesson here is that the greater the degree of market competition, price transparency, and out-of-pocket payments, the more constrained prices are, in health care or any other sector of the economy. Another important economic lesson is that the greater the degree of government intervention, opaque prices, and third-party payments, the less constrained prices are, in health care or any other sector of the economy. Some important lessons to consider as we attempt to reform national health care... once again.

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