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How Your Doctor Is Driving Up Health Care Costs

Financial incentives facing doctors and hospitals are pushing up costs.

By Sita Slavov | Aug. 22, 2013 | 9:00 a.m. EDT + More

The best approach to improving outcomes is to understand the behavioral changes and social aspects that lead to improved health, says Dr. Fauzia Khan of Alere Analytics.

Most of us have had the experience of taking our car to the mechanic for routine maintenance, only to have the mechanic recommend thousands of dollars' worth of repairs. For those of us without expertise in auto repair, this can be frazzling; it's not clear whether we can trust the mechanic because we know it's in his financial interest to perform unnecessary repairs. And indeed, there are some mechanics who take advantage of uninformed consumers to boost their own incomes.

The same story applies to doctors. When a doctor tells us that we need a particular test or procedure, most of us are at an informational disadvantage. Not being medical experts, we can't be sure if the test or procedure is really necessary, or if the doctor is merely looking to enhance her own bottom line. In the latter case, we have what is known as "physician-induced demand," a documented phenomenon that results in overtreatment and contributes to high health care costs.

But there's one group of consumers who are not at an informational disadvantage when it comes to

health care: doctors. When doctors seek medical treatment for themselves, their own medical knowledge makes them less likely to fall prey to overtreatment. One way to determine whether physician-induced demand is really a problem, then, is to compare the medical treatment that doctors themselves receive with the medical treatment that other patients receive. This approach is somewhat like comparing the repairs that auto mechanics make to their own cars with the ones they recommend to their customers.

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That's exactly what Erin M. Johnson and M. Marit Rehavi, of the Massachusetts Institute of Technology and the University of British Columbia respectively, have done in a recent study entitled "Physicians Treating Physicians: Information and Incentives in Childbirth" (hat tip to Ben Ho). These two researchers used data on first births that took place in California between 1996 and 2005, and they showed that mothers who are doctors were 9 percent less likely to have unscheduled C-sections (i.e., C-sections that occur after attempting labor) compared to non-physician mothers with similar characteristics. That's consistent with the physician-induced demand hypothesis because, from the provider's perspective, C-sections are typically more profitable than vaginal deliveries.

But not all doctors have a financial incentive to overtreat patients. In particular, some hospitals are owned and operated by health maintenance organization (HMO) insurance companies. At these hospitals, doctors are salaried employees who receive no financial rewards for performing unnecessary C-sections. In fact, HMO-owned hospitals may actually have an incentive to undertreat less-informed patients, as the hospitals themselves bear the full cost of the treatments that they provide.

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Johnson and Rehavi found that non-physician mothers who gave birth in non-HMO-owned hospitals were indeed more likely to have C-sections than non-physician mothers with similar characteristics who gave birth in HMO-owned hospitals. That supports the claim that doctors' financial incentives play at least some role in their treatment of uninformed patients. But there's even stronger evidence for the physician-induced demand hypothesis: it turns out that physician-mothers were about equally likely to have C-sections regardless of whether they gave birth at an HMO-owned hospital. In other words, financial incentives don't seem to affect the choice of treatment for informed patients.

All of this suggests that the financial incentives facing doctors and hospitals may be important in driving health care costs, particularly when patients are poorly informed about the risks and benefits of their treatment options. Johnson and Rehavi estimate that doctor and hospital fees could fall by 3 percent, or almost $2 billion, if non-physician mothers received the same kind of treatment as physician-mothers. They further note that even the C-section rate for physician-mothers may be too high – in the sense that the social cost of the procedure may exceed its benefits for some in this group – because insurance reduces patients' sensitivity to the cost of their own treatment.

In coming decades, policy makers will have to take serious steps to bring health care costs under control. As they do, it is important that they not ignore the financial incentives facing both doctors and patients.

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