



DO CERTIFICATE-OF-NEED LAWS LIMIT SPENDING?

In 35 states and the District of Columbia, certificate-of-need (CON) laws require healthcare providers planning to offer or expand certain services to first prove to a state regulator that their community “needs” the particular services in question. These laws are controversial. Many experts question their effectiveness and worry that they undermine competition to the detriment of patients.

Still, proponents of these laws believe that they rein in healthcare spending. A new study from the Mercatus Center at George Mason University provides a comprehensive review of the theoretical and empirical research on the relationship between CON laws and spending. After analyzing the theoretical arguments and reviewing 20 academic studies spanning 40 years, a clear lesson emerges: CON laws restrict competition in health care, driving up the cost of obtaining medical services.

To read the study in its entirety and learn more about the author, Mercatus Senior Research Fellow [Matthew D. Mitchell](#), see “[Do Certificate-of-Need Laws Limit Spending?](#)”

THEORY

The Original Purpose of CON

CON laws were originally intended to rein in the excessive growth of healthcare costs stemming from the government’s “cost-plus” reimbursement structure for hospitals. Cost-plus essentially paid hospitals for whatever they spent with no incentive to control costs. The government has since abandoned cost-plus reimbursement, leaving supporters of CON laws to find alternative arguments for why restricting the supply of health care might lower costs:

- *The third-party-payer problem.* This argument suggests that the supply of medical care must be restricted because the prevalence of third-party payers—such as government programs and insurance companies—leads to an overconsumption of medical services. However, economic theory predicts that a supply restriction will unambiguously increase per-unit costs. Moreover, when third-party payment causes inelastic demand for health care, theory further predicts that a supply restriction such as CON will increase rather than decrease total spending.

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- *Economies of scale.* This argument contends there are economies of scale in the provision of medical services, suggesting that fewer large hospitals might be able to deliver care at a lower cost than many small ones. However, there is little evidence to suggest that the healthcare industry is one in which a single seller naturally emerges; if it were, restrictions such as CON would be unnecessary.

The Interest-Group Theory of Regulation

A more realistic theory suggests that CON affords a privilege to a special interest group, namely the incumbent providers who benefit from restricted competition. These providers organize and lobby for the continuation of CON laws to the detriment of consumers, who are far too numerous to organize easily or effectively.

DATA

A review of published research shows that CON laws are associated with higher per-unit healthcare costs and higher total healthcare expenditures over a given time period. There is mixed evidence on whether CON laws increase the efficiency of particular hospitals by limiting patient access to alternatives. There is no evidence that these laws reduce unnecessary hospital investments as policymakers had hoped.

- *Per-unit costs.* As predicted by economic theory, the balance of empirical evidence suggests that CON laws are associated with higher per-unit healthcare costs.
- *Total patient expenditures.* None of the published studies found a direct effect on lowering total patient expenditures, and seven of these studies found evidence that CON increases expenditures.
- *Hospital efficiency.* The literature is mixed on the question of hospital efficiency, with some studies finding that CON laws increase some measure of hospital efficiency, one study finding no effect, and one study finding that CON laws reduce efficiency.
- *Hospital investment.* Studies that measured the goal of reducing unnecessary investments showed that CON has failed in this regard. One study found that CON failed to reduce investment, while another found that CON actually backfired, causing hospitals to increase investment before CON implementation in anticipation that future investments would be more difficult.

CONCLUSION

Economic theory predicts that a supply restriction such as a CON law will unambiguously increase per-unit costs. Theory further predicts that CON might decrease overall spending on health care if consumers significantly reduce their consumption of healthcare services in response to the price increase. However, in a healthcare industry dominated by third-party payers, patients are unlikely to respond significantly to changes in price.

The data are consistent with this theory. A review of 20 academic studies finds that CON laws have largely failed to achieve their stated goal of reining in healthcare costs. The overwhelming balance of evidence suggests that CON laws are associated with both higher per-unit costs and higher expenditures. This is consistent with the special-interest theory of regulation.