Esther Peterson to Senator James O. Eastland, 28 September 1978

Esther Peterson

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The Senate will soon be considering legislation designed to contain hospital cost inflation. Hospital costs, which account for 40 percent of health care expenditures, are the most inflationary element in the health care sector. Accordingly, the effective containment of hospital costs will be a major step toward stemming health care inflation, saving consumers and taxpayers billions of dollars.

Cost containment legislation is necessary to provide the kind of discipline which price competition usually imposes on markets for goods and services, but which is missing from the market for hospital services. Because over 90 percent of the costs are paid by third parties -- insurance companies, Medicare, or Medicaid -- rather than directly by consumers, a hospital's expenditure often dictates its revenue. If costs go higher, revenues are simply raised sufficiently to cover them. Cost containment legislation would provide the discipline and incentive which is presently missing and cannot be obtained by other methods.

Mandatory cost containment has already proven to be an effective method of introducing market discipline in the nine states (Colorado, Connecticut, Maryland, Massachusetts, New Jersey, New York, Rhode Island, Washington, and Wisconsin) which have implemented it. Voluntary programs, now in effect in several states, have proven far less effective.

The Administration supports S. 1391 as the most effective cost containment proposal. If implemented, this program could save consumers more than $40 billion and taxpayers more than $19 billion during the next five years.

The amendment to H.R. 5285 proposed by Senator Nelson is a compromise which the Administration can also support. The Nelson proposal would statutorily accept the hospital industry's voluntary cost control program, while authorizing standby mandatory
controls. In the event the voluntary effort fails, the standby controls would go into effect. Enactment of the Nelson proposal would result in savings to the consumer and taxpayer estimated at between $30 and $35 billion over the next five years.

All of us are deeply concerned about inflation in both the health care sector and the economy generally. Your support for a realistic and effective cost containment bill will be an important contribution to our efforts to achieve price stability and sustain the growth of our economy.

Sincerely,

Esther Peterson
Special Assistant to the President
for Consumer Affairs

The Honorable James O. Eastland
United States Senate
Washington, D.C. 20510