ket. Our unlimited government funding of hats has completely cut out the need for competition. Any hatmaker can stay in the business, no matter how high his prices.

Lesson Two: prices will skyrocket if there's no limit to how much people can spend on a product. If anyone who wants the product can buy it, price no object, there is absolutely no reason for the manufacturer to try to cut his prices, and no reason for the buyer to control how much he spends.

The government, and *only* the government, can give people virtually unlimited amounts to spend on a product. In short, it is not the greed of the manufacturer or the consumer, but the mere fact of the government funding of hats that is making hat prices exorbitant.

Next step: the government, and hence the taxpayers, are faced with enormous hat bills. Mrs. Smith may have confined herself to one hat, but Mr. Jones wanted five, and Mrs. Imelda wanted 52 Paris originals. The government knows it can't continually raise taxes to pay for hats. Assuming it wants to keep the hat program intact, it has two choices: restrict the number of hats any one person can buy, or restrict the price of hats. In political jargon, that means rationing or price controls.

From a politician's point of view, setting limits on the price of hats is the obvious way to go. There are fewer hatmakers who vote than there are hat wearers, and it's easy enough to paint the hatmakers as greedy exploiters of the hatless. So a new law is passed: no hats may be sold for more than $15, even if the buyer is willing to use his own money. The immediate result will be that the best quality, most expensive hats become unavailable. No more Paris originals.

Lesson Three: you can't make a silk purse out of a sow's ear. Good materials and good workmanship cost money. Yes, competition among manufacturers in a free market will cut prices in the long run. However, legislating a lower price for a product is not a shortcut to cheapness. It merely makes those who were selling more expensive goods go bankrupt, before anyone has time to work on price reduction.

We could try some complicated and devious maneuvers to lessen the effect of price controls. For instance, we could slap a $5 tax on shoes and use the money for the hat program. Then we could have a maximum hat price of $15, but still pay the hatmakers $20 per hat. That would mean, of course, that some poorer people wouldn't be able to afford shoes, and the government would end up subsidizing shoes, too. Even so, price controls on hats will have to be instituted in some form, because demand is so high. Remember that it is government spending for hats that made the demand and the prices so high in the first place: nothing except removal of the government's money will get the situation back under control. But let's keep trying.

We've now legislated a maximum price for hats. Nevertheless, Mrs. Imelda has bought another 35 hats, and the rest of us are still trying to get our taxes' worth of hats. Not surprisingly, the amount that taxpayers are shelling out for hats hasn't significantly decreased, despite our price controls. The next step? Well, of course, restrict the number of hats each person can buy: ration them.

Now what happens? A lot of hatmakers go out of business. They can't sell hats for more than the maximum price, and they can't make up for the loss in income through selling more hats. Bureaucrats demand forms in triplicate and slap fines on them at every turn. The best hatmakers soon leave the field in disgust. We are now facing a decreasing supply of hats, if not an actual shortage, because there are far fewer manufacturers.

But hats are a necessity, aren't they? So we will have to pass a law forcing hatmakers to remain in business, whether they can make a profit or not. However, even a government order can't make a business run for long at a deficit, whether it's a hatmaker or a child's lemonade stand or a bank. The hatmakers will go out of business, one by one.

The government will have to step in and make hats. Given the quality of most government products, you can imagine what kind of hats we'll get. And given the efficiency of most government manufacturing operations, we won't be surprised if we're told we can each have one hat, in our choice of four styles, every other year.

What began as a seemingly praiseworthy law—to provide all Americans with hats—has ended up driving the hatmakers we know and trust out of business, and given us government-produced hats of considerably inferior quality and very limited numbers. This result is absolute, inevitable, and non-negotiable: none of the economic rules above can be avoided, and they can only be temporarily circumvented by allowing the government to interfere in yet more private business.

Lesson Four: what the government pays for, the government has to control. Government funding of hats led to government control of hat prices, hatmakers, and finally everyone who is even remotely connected to hats. The only cure would be to end government funding of hats.

Back to Health Care

Comparing hats to medicine may seem even less appropriate than comparing apples to oranges, but the same economic principles apply, and precisely the same developments can be seen in the 26-year history of Medicare.

In 1965 the government passed Medicare legislation, providing basic medical services to the nation's retirees. Physicians and hospital administrators were delighted. They built new hospitals and enlarged old ones. They began providing the medical equivalent of the best Parisian hats to all comers. Why not? The government encouraged physicians by asking them just to send the bill to the American taxpayer. Patients, as well as physicians, no longer had to consider costs. Everyone simply demanded "the best"—price no object. Medical expenditures in the United States were 4.3 percent of GNP in 1952; by 1982 they exceeded 10 percent, and were still rising. In the same period the government's share of these expenses nearly doubled, from 22 percent to over 40 percent. Here is Lesson One in action: with the government footing the bill for a substantial number of those receiving medical care, there was suddenly an enormous demand for medical services.

At the same time, prices for medical care soared. The legislation deliberately removed any incentive to keep prices low: in fact, removing concern about costs was the point of the program. Many of us can remember that prior to 1965 a few days in the hospital did not threaten to bankrupt the average middle class family. Today, many find the cost of a hospital stay prohibitive, because the rise in medical costs has far outpaced the general inflation rate.

Why? Because of Lesson Two. Prices skyrocketed precisely because the government was providing unlimited funds for medical care. Consumers demanded the most expensive treatment, and medical facilities didn't have to keep prices low to maintain a competitive edge.

By 1983, Medicare threatened to bankrupt the entire Social Security system. It was clear that something drastic had to be done to control runaway costs. Taxes were raised, of course, but this was not enough. Like the manufacturers in the hat illustration, health-care professionals were (and continue to be) denounced as the greedy culprits who had to be controlled; price controls were slapped on hospitals and doctors. Under this system, called Diagnosis Related Groups, all hospital admissions of Medicare patients are classed in one of 486 categories, and the hospital receives a set fee for the patient, regardless of his length of stay or the amount of care provided. When it was pointed out that this might lead to inadequate treatment and early discharges ("quicker and sicker" releases), the government responded by imposing further complicated regulations.

The federal government has also set a limit on what doctors can charge patients over the age of 65, and some states now refuse to license doctors who don't accept the Medicare fee as full payment. Just to receive the government-approved payment, doctors must comply with a bewildering, and sometimes contradictory, array of regulations from several different agencies. The process a doctor is required to go through to obtain payment from Medicare makes filing your tax return look like simple arithmetic, and your doctor does it many times per day, not once a year. Also, a simple error in filing that would result in no monetary gain for him, such as using an incorrect code for a diagnosis, can mean no payment at all on the claim, plus a fine of thousands of dollars.

Not surprisingly, doctors are leaving the profession and the number and quality of medical school applicants are falling. In 1974 there were nearly three applicants for every opening in medical school; by 1986 there were fewer than two. What bright young college graduate would want to get involved with such a mess?

Lesson Three comes into play: you can't make a silk purse out of a sow's ear. In this case, you can't get top-notch, dedicated individuals to enter and remain in the medical profession while controlling their activities and their earnings, and calling them greedy exploiters to boot.

And guess what? Costs are still rising uncontrollably, despite stringent controls on medical expenditures. (Given the fact that it was government funding that made prices skyrocket, and that the government is still funding medical care, the con-