

Practice Final Exam A reviewed in this week's sections  
 Practice Final Exam B available on course web page

Please be sure to participate in online CAPE evaluation of Professor Hamilton

## Chapter 14: The Environment, Health, and Safety

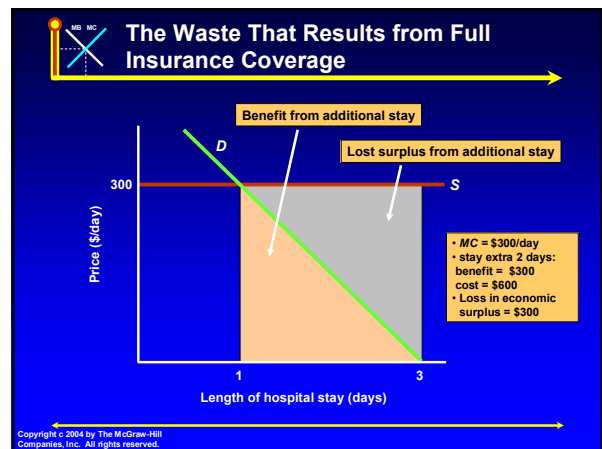
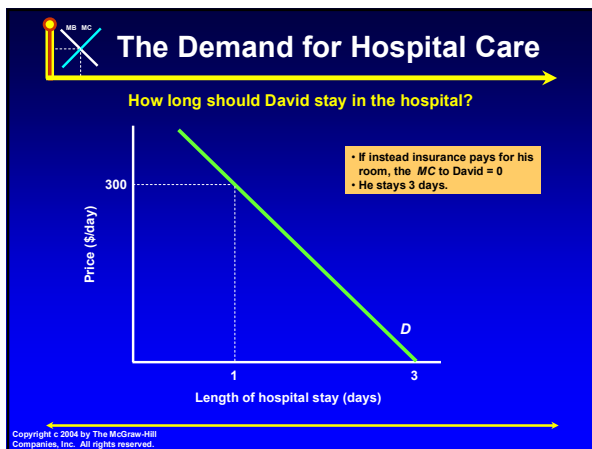
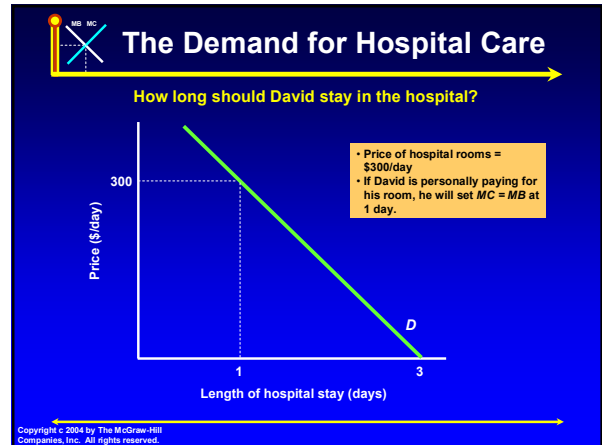
- A. The optimal amount of safety
- B. Workplace safety regulation
- C. Value of life
- D. Rising health expenditures
- E. Effect of third-party payment system

### The Economics of Health Care Delivery

Example

- How long should David stay in the hospital?

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Conclusion: if insurance company pays all the costs, too much health care gets consumed

One way to see this:

- Suppose that instead of paying hospital, insurance company gave David \$700 to spend as he wanted
- Insurance company only spends \$700 rather than \$900
- David gets 1 day hospital (value = \$300) plus \$400 rather than 3 days hospital

## Chapter 14: The Environment, Health, and Safety

- A. The optimal amount of safety
- B. Workplace safety regulation
- C. Value of life
- D. Rising health expenditures
- E. Effect of third-party payment system
- F. Possible solutions to the overprovision problem
  1. Higher patient deductible  
e.g., David pays first \$800 on his own

### High-deductible policies

- Solves the incentive problem for low-cost procedures and protects people against financial catastrophe
- But poor may not be able to afford the deductible
  - Poor could be given yearly stipend to defray costs
  - Could keep any unspent stipend at the end of the year

Manning, et. al. health insurance experiment:  
Families randomly assigned to different types of insurance coverage  
Some policies: insurance pays all costs  
Other policies: family pays all costs up to \$1,000

Finding: when families pay costs, they spend 40-50% less on health care with no observable differences in health outcomes

- F. Possible solutions to overprovision problem
  1. Higher patient deductible
  2. Managed care plans (HMO and PPO)

### Health maintenance organization (HMO)

- Patient receives medical services from a specific group of physicians, e.g. Kaiser Permanente
- Patient pays fixed annual fee
- Specific procedure for getting approval of any given medical service
- Reduced incentives to prescribe expensive tests
  - The doctor receives no additional fee for prescribing and interpreting tests

### Preferred provider organization (PPO)

- Blue Cross of California is an example
- Insurance reimburses a higher portion of patient's costs if medical services are performed by approved physicians
- Physicians are approved based on their willingness to charge low fees

### Effect of managed care plans

- 2/3 of Americans now covered by managed care plans
- Effect of managed care is to give the third-party payer (HMO or PPO) more direct control over which medical services get provided
- Advantage: can avoid overspending
- Disadvantage: patient may disagree that procedure is unnecessary

### F. Possible solutions to overprovision problem

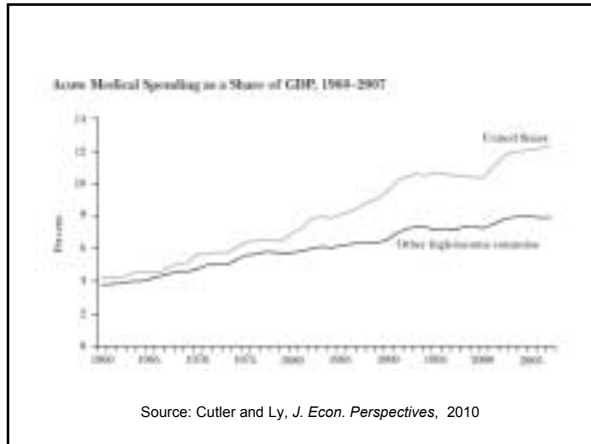
1. Higher patient deductible
2. Managed care plans
3. Tax changes

Why was U.S. relying on third-party payment system if it is so inefficient?

Some economists point to tax-deductibility of employer's medical contribution

### F. Possible solutions to overprovision problem

G. Administrative efficiency



In 2002, U.S. spent \$1,589 per person on hospitals and physicians more than Canada

(1) \$224 (= 14%) from additional procedures in U.S.

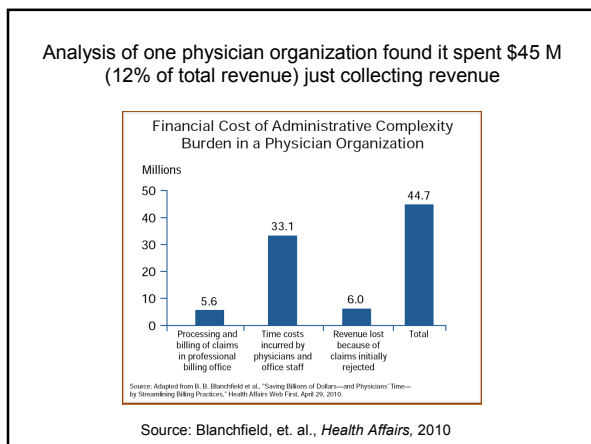
Source: Cutler and Ly, *J. Econ. Perspectives*, 2010

(2) \$490 (= 31%) from higher provider incomes

U.S. physicians earn 33% more

U.S. specialists earn 50% more

(3) \$616 (= 39%) from higher administrative costs



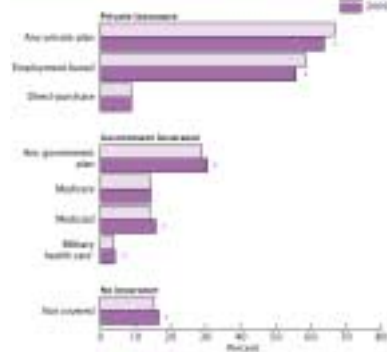
F. Possible solutions to overprovision problem

G. National health care debate

## Why do some say we need national health care?

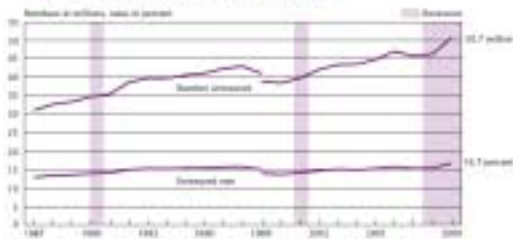
(1) Many Americans have no health insurance

Coverage by Type of Health Insurance: 2008 and 2009



Source: "Income, Poverty, and Health Insurance Coverage in the United States: 2009", U.S. Census Bureau, September 2010

Number Uninsured and Uninsured Rate: 1987 to 2009



Source: "Income, Poverty, and Health Insurance Coverage in the United States: 2009", U.S. Census Bureau, September 2010

Of 50.7 million uninsured in 2009:

- 28.4 million under age 35
- 9.9 million not U.S. citizens

### Why no insurance?

- Adverse selection: healthy people don't buy, market can break down from lemons problem
- Employment based: problem for self-employed and unemployed
- They count on others picking up cost (e.g., emergency room) if problem

## Why do some say we need national health care?

- (1) Many Americans have no health insurance
- (2) Coverage for pre-existing conditions

Distinguish between two questions:

(1) Before we know which individual we're talking about.

In this case it is a question of pure insurance, e.g., a group all pool their resources for something that benefits all of them

Distinguish between two questions:

(2) After we know which individual we're talking about.

In this case it is a question of pure transfer of resources to those who need them

Example:

true insurance would not cover pre-existing conditions

pure transfer would

Why do some say we need national health care?

- (1) Many Americans have no health insurance
- (2) Coverage for pre-existing conditions
- (3) Cost containment

How do we decide which procedures not to conduct?

- free market: if you can't afford it, you can't get it
- national health care: government decides

F. Possible solutions to overprovision problem

- G. National health care debate
- H. Alternative solutions

- Current system for government assistance: we specify what procedures government covers and try to find the money
- Alternative philosophy: we specify how much money the government contributes and you're on your own for the rest

- Ryan-Rivlin plan
- Alice Rivlin (moderate Democrat)
- Paul Ryan (conservative Republican)

- Beginning in 2013, all Medicare enrollees would be protected by a \$6,000 cap on out-of-pocket expenses; in return they would pay for more small expenses on their own.
- Beginning 2023, people newly eligible for Medicare would receive a voucher to purchase private insurance instead. The value of the voucher would grow at the rate of growth of GDP plus 1% (vs. GDP plus 2% historical growth).
- Medicaid would be turned into annual block grants to the states. The value of the block grants would also grow at GDP growth plus 1%.

Key issue behind any proposal:  
How do we decide who gets treatment and who doesn't?