Health Economy

Choice, Commerce, and Conflict
Ryan Doody

Contents:

Market Failure: Public Goods

Expect:
Underproduction

Why?
1. Free Rider Problem
2. Assurance Problem

What can be done?

Market Failure: Public Goods

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Expect:
Underproduction

Why?
1. Free Rider Problem
2. Assurance Problem

What can be done?

Non-rival & Non-excludable

Example: Pandemics & Public Goods

Example of Public Goods?

Cowen argued (in 2013) that our health care policies were not ideal for dealing with pandemics.

Why?

Example of Public Goods?

Cowen argued (in 2013) that our health care policies were not ideal for dealing with pandemics.

Why?

Our current health care policies are not optimal for dealing with pandemics. The central problem is that these policies neglect what economists call “public goods”: items and services that benefit many people and can’t easily be withheld from those who don’t pay for them directly.

Protection against communicable diseases is a core example of a public good, as is basic scientific research, which can yield new ideas that may be spread at very low additional cost. (In contrast, Medicare, which is publicly financed, has some elements of a public good, but any particular expenditure tends to benefit an individual receiving treatment, rather than being spread over a number of beneficiaries.)

Solutions to Public Goods?

Solutions to Public Goods?

Focusing government on the production of public goods may sound like a trivial issue, too obvious to be worth a mention. But, in fact, we have been failing at it, and the consequences could be serious indeed.

Solutions: Government Intervention

Because of **Free Riders**, the market will underproduce public goods.

Solution: Government provides them.

How does this work? Taxes.

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Problem: The Forced Rider Problem

Solutions: Government Intervention

The Forced Rider Problem

People are forced to contribute to the production of some good whether or not they want it.

Information Problem

How do we know which Public Goods to produce?
(Voting? Gathering information? Both are *themselves* Public Goods.)

Market Failure: Solutions?

What are some other solutions?

- Commitment Contracts
- Bundling (e.g., advertisements)
- Make excludable
- Others?

Asymmetric Information

Market Failure

Causes of Market Failures:

- Externalities
- Non-excludability
- **Asymmetric information**
- Transaction costs

ARGUMENT FOR THE EXCHANGE CLAIM

P1 X would be voluntarily exchanged for Y only if the person who has X (Person A) prefers having Y to having X and the person who has Y (Person B) prefers having X to having Y ($Y \succ_A X$ and $X \succ_B Y$).

P2 If $Y \succ_A X$ and $X \succ_B Y$ then both A's and B's preferences are better satisfied by engaging in the transaction than by not.

P3 Satisfying a preference makes one better-off.

P4 No one else is affected by the exchange.

C If X is voluntarily exchanged for Y, then the participants of the exchange are made better-off and no one is made worse-off.

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Asymmetric Information

Economic transaction involves *asymmetric information* when one party to the transaction has more information about it than the other.

Examples:
Used car sales
Finance
Health insurance
Etc.

Asymmetric Information

George Akerlof's theory of *Adverse Selection*.

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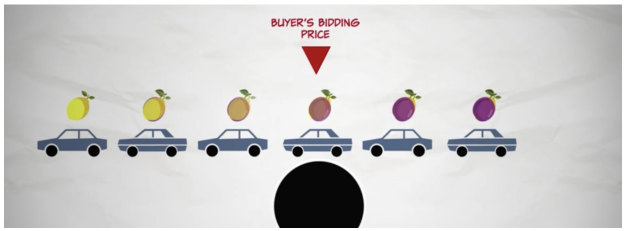
Used Car Market:



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Used Car Market:

What's causing the problem? What can be done to help?

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Used Car Market:

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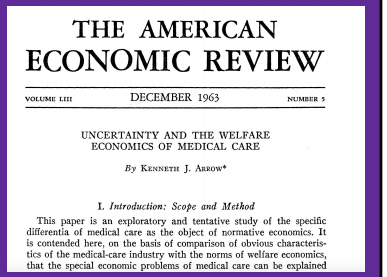
CARFAX VEHICLE HISTORY REPORTS

QUALITY ASSURANCE

CERTIFIED CERTIFIED

Uncertainty & Medical Care



THE AMERICAN ECONOMIC REVIEW

VOLUME LIII DECEMBER 1963 NUMBER 5

UNCERTAINTY AND THE WELFARE ECONOMICS OF MEDICAL CARE

By Kenneth J. Arrow*

I. *Introduction: Scope and Method*

This paper is an exploratory and tentative study of the specific differentia of medical care as the object of normative economics. It is contended here, on the basis of comparison of obvious characteristics of the medical-care industry with the norms of welfare economics, that the special economic problems of medical care can be explained

Kenneth Arrow

American Economist
1921-2017

Uncertainty & Medical Care

Postscript

I wish to repeat here what has been suggested above in several places: that the failure of the market to insure against uncertainties has created many social institutions in which the usual assumptions of the market are to some extent contradicted. The medical profession is only one example, though in many respects an extreme one. All professions share some of the same properties. The economic importance

Arrow, "Uncertainty and the Welfare Economics of Medical Care"

Uncertainty & Medical Care

Arrow identifies several sources of uncertainty / asymmetric information in the health care sector.

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- Patient/Doctor Relationship
- Health Insurance

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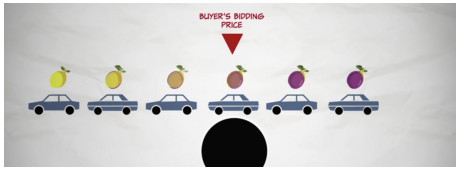
Patient/Doctor Relationship

Uncertainty & Medical Care

Patient/Doctor Relationship

Doctors have better information about health conditions and interventions than patients.



Uncertainty & Medical Care

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What Can Be Done?

Uncertainty & Medical Care

Patient/Doctor Relationship

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What Can Be Done?

Quality Assurance with licensing

Relationship of trust between doctors and patients

Health Insurance

Uncertainty & Medical Care

Health Insurance Market

Consumers have better information about their health than insurers.

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What Can Be Done?

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The Affordable Care Act (ACA, or “Obamacare”), 2010:

- Subsidizes the cost of buying insurance
- Disallows insurance companies to discriminate based on pre-existing conditions
- The Individual Mandate: everyone must purchase health insurance

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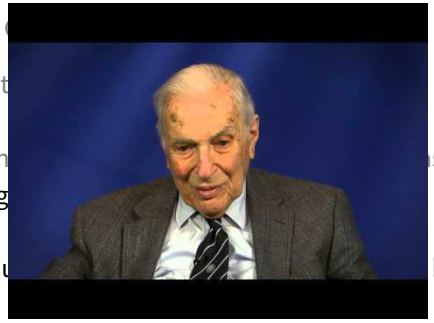

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Challenged by the court (2012); upheld as a tax
Tax was made 0% in 2017.
New court challenge

Obamacare

LAW

Obamacare Wins For The 3rd Time At The Supreme Court

Updated June 17, 2021 · 5:05 PM ET
Heard on Morning Edition

NINA TOTENBERG

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We haven't seen an insurance market "death spiral".

Why not?

Moral Hazard

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When you have an incentive to increase your exposure to risk because you no longer stand to suffer the full costs of that risk.

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Principal-Agent Problem
One person (the “agent”) is able to make decisions on behalf of another (the “principal”). Their interests may diverge.

Moral Hazard

When you have an incentive to increase your exposure to risk because you no longer stand to suffer the full costs of that risk.

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One person (the “agent”) is able to make decisions on behalf of another (the “principal”). Their interests may diverge.

Insurance can create *moral hazards*.

Moral Hazard

When you have an incentive to increase your exposure to risk

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What Do You Think?