Introduction to Health Economics

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Today's Agenda

- What is economics?
- How do economists think?
- What do economists believe?
- What is special about health economics?
- What are the current issues in health economics?

What is economics?

Economics does not have the best reputation

“An economist states the obvious in terms of the incomprehensible.”

Alfred A. Knopf

“If all the economists were laid end to end they would not reach a conclusion.”

George Bernard Shaw

“The dismal science”

Carlyle and many others over the years

But, what is economics?

- One of the Social Sciences
- As **social**, economics broadly considers people, their decisions, actions and interactions
- As **science,** it works with the scientific method: data, theory, data
- As compared to other Social Sciences
  - **Economics** is about the domain of markets and allocation of scarce resources
  - **Political Science** concerns itself with the domain of authority
  - Philosophy and in modern times **Psychology** works in the domain of thought, emotion, and persuasion
- Fundamentally, Economics is the science that answers the questions:
  - What goods and services are produced? At what cost?
  - How are they produced and exchanged?
  - Who gets them?

What do economists believe?

Among the beliefs of economists are:

- People face trade offs; fundamental scarcity is the norm
- People respond to incentives
- Markets are usually good and market prices help resolve issues involving scarcity
- Government can sometimes improve market functioning or deal with market failure
- Efficiency and equality need a lot of discussion

How do economists work?

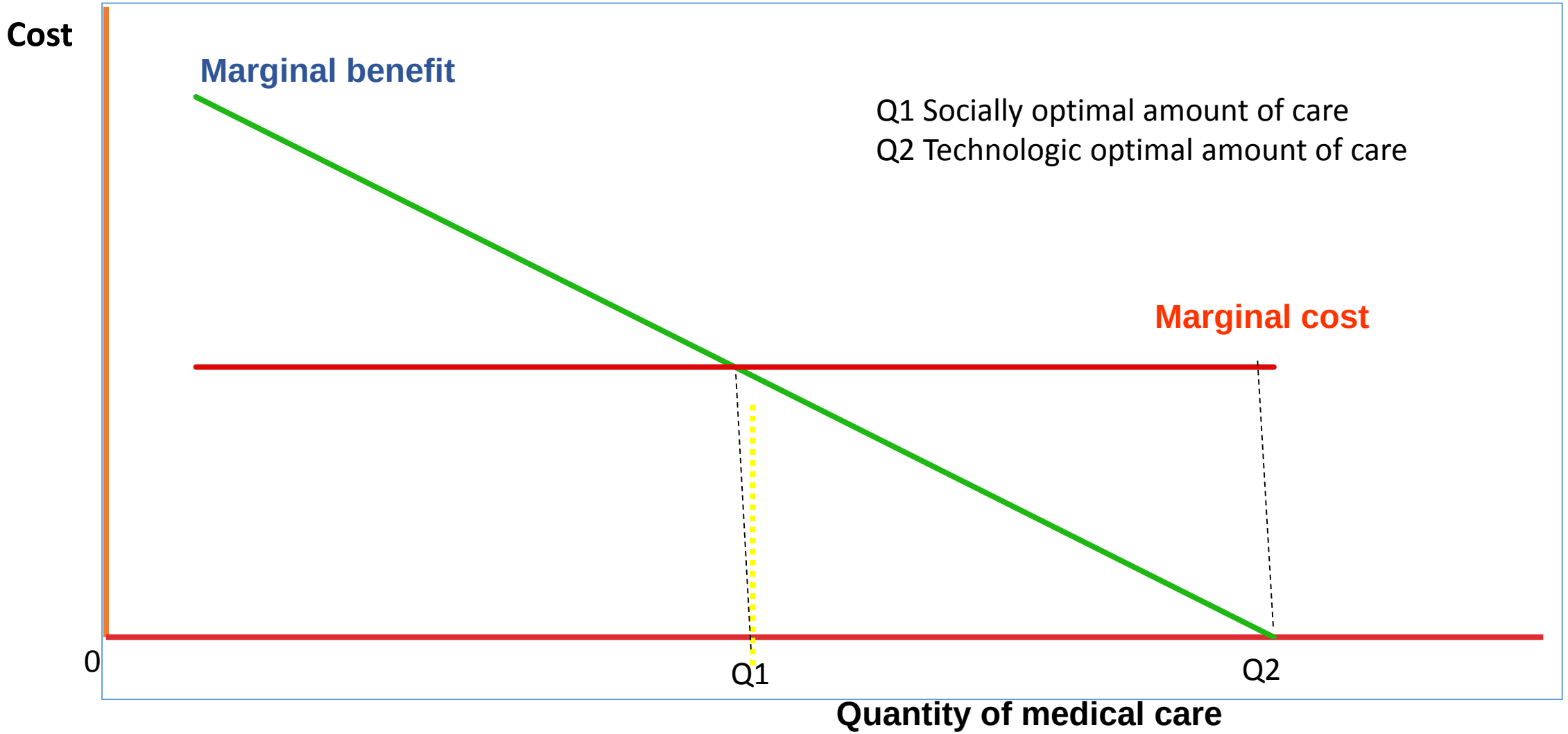
- Much like engineers, Economists deal with constrained optimization. What is the best we can do given the constraints and uncertainties that we face.

- Economists' work is both data rich and data poor.

- Economists make strong assumptions concerning rationality and the pursuit of wealth.

- Economists communicate their work in multiple ways.
  - Intuitive
  - Graphical
  - Mathematical

An Economics Model in a Graphic



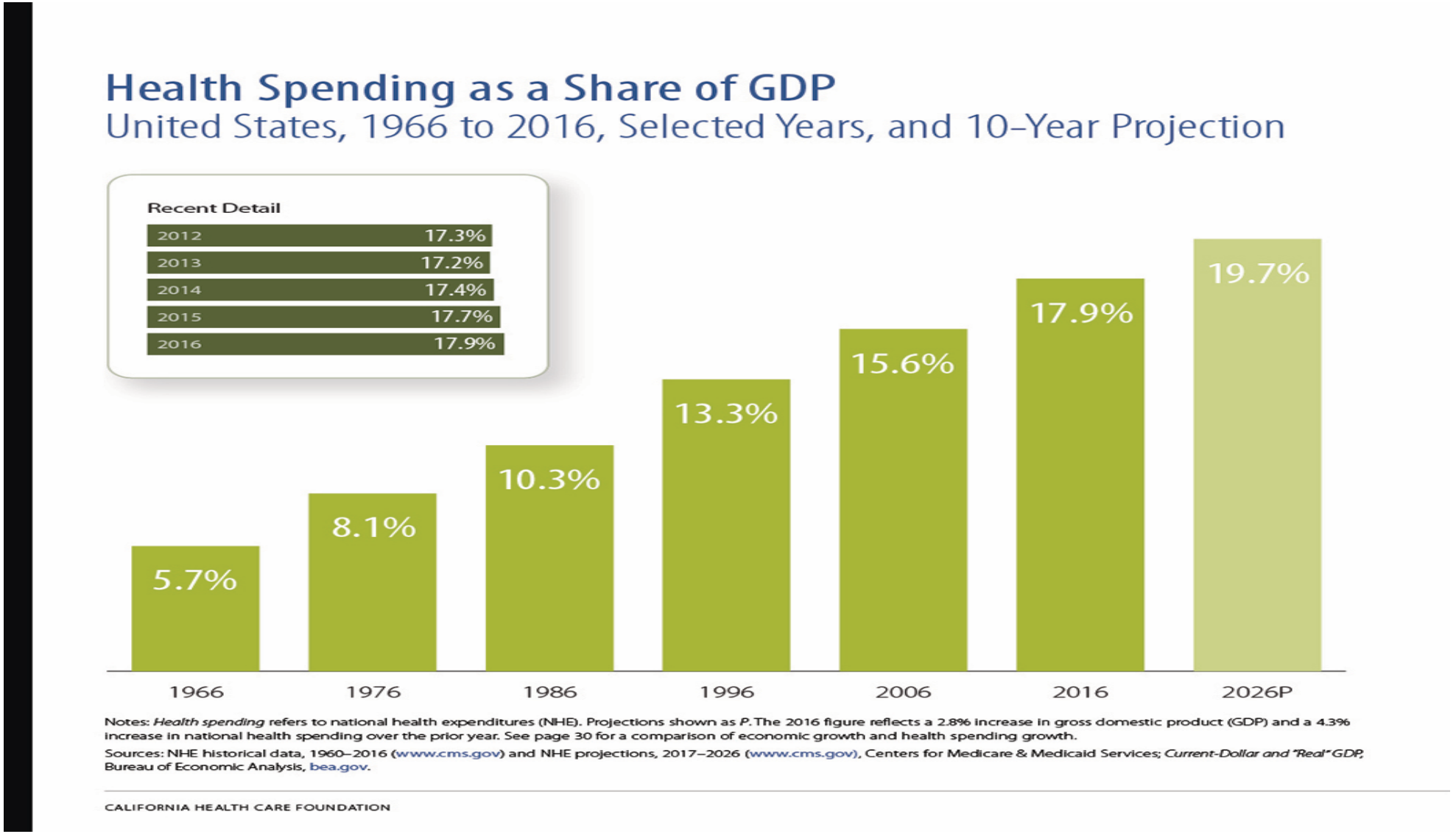
So what is special about *Health* *Economics*

With some apologies to Kenneth Arrow, here are some things that get in the way of economic analysis:

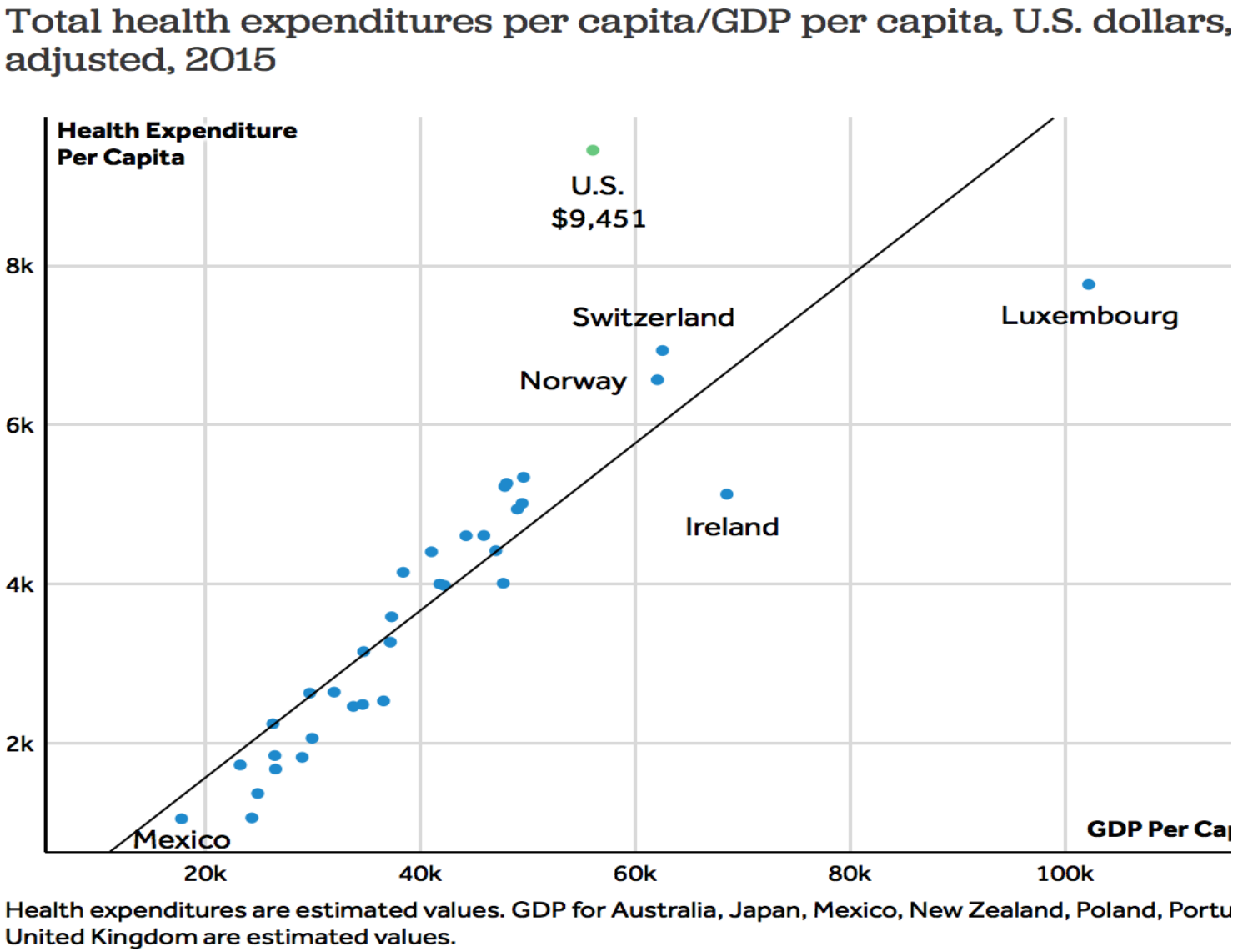
- **High stakes: life and death, health and illness for the individual; trillions for society**
- Highly charged normative questions
- Deep government involvement as both payer and regulator
- Skewed consumption across the population
- Uncertain “product” definition
- Intractable uncertainty
- Lots of externalities
- Third party agency—payers and providers of care
- Asymmetric information

What is really special is that all the above apply to Health Economics

Health Care Spending Consumes a Large and Growing Share of US GDP



The US Health Care Spending in International Perspective



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US Health Care Spending, Payment Sources, 2015

- Payment Sources for US Health Care Spending
  - Medicare—22%
  - Medicaid—17%
  - CHIP—1%
  - Other Government Paid (Including Military, Veterans, Indian Health Services, and civilian employees)—7%
  - Public Health Expenditures--3%
  - Government Administration—<1%
  - Tax expenditures—unknown to me but substantial, probably more than 4%
  - Employers and Individuals—40%
  - Other—up to 5%

- So, by my estimates, at least 55% government paid

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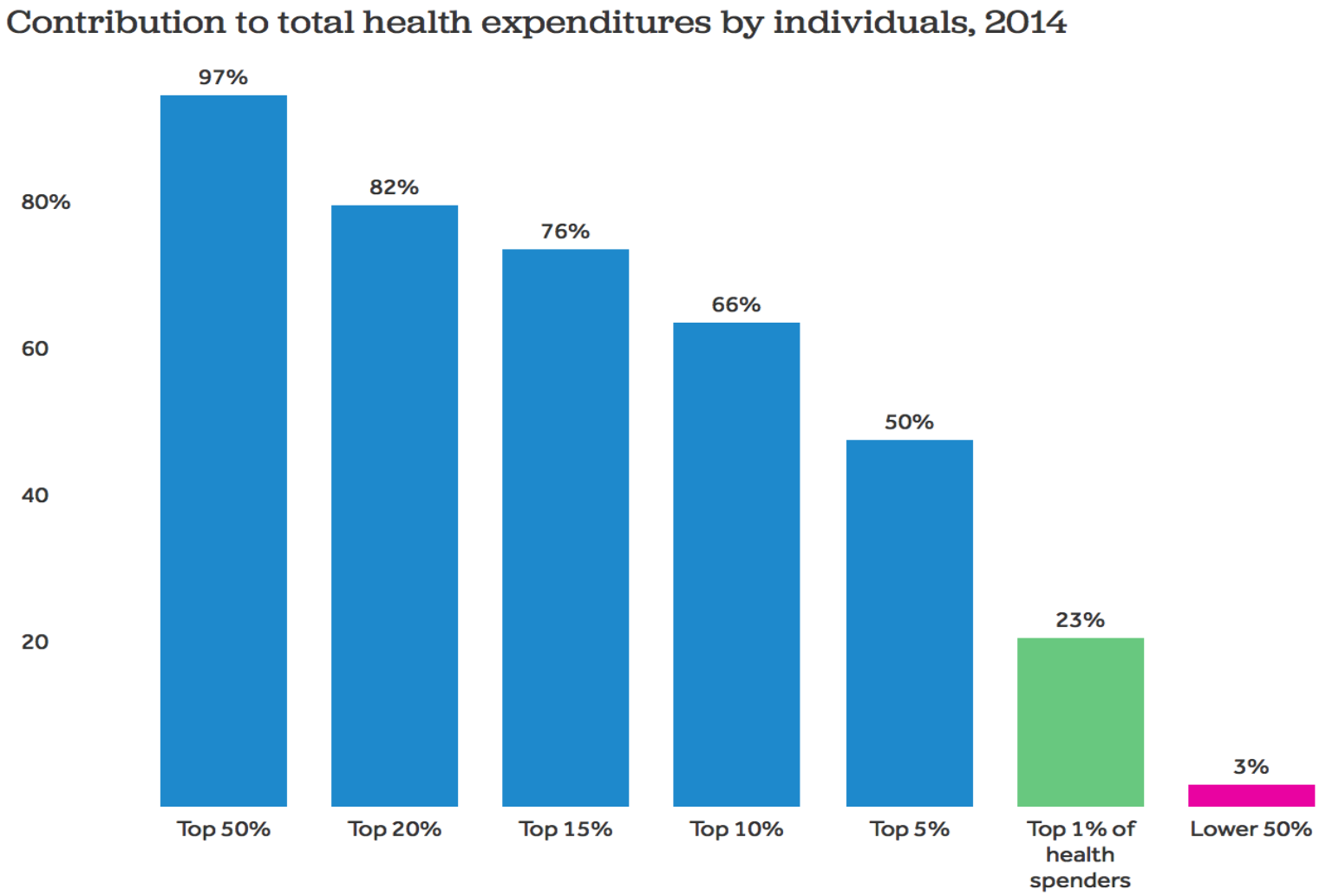
Spending varies considerably across the population



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Some Key Issues in Health Economics

- Insurance and Third Party Payers
  - Moral Hazard
  - Risk pools
  - Adverse selection
  - Death spiral
  - Pre-existing conditions
  - Guaranteed issue
- Hospital, Physician, other Provider Compensation
  - Fee for Service
  - “Bundled” or episode of care payments
  - Pre-payment, Bundled Payment, Capitation
  - Pay for Quality
- Care Delivery Organization
  - Health care ”guilds”
  - Vertical and horizontal integration
  - Any willing provider

The Policy Issues of Today

- Whither Health Insurance: the ACA and Responses to the ACA?
  - Individual mandate
  - Guaranteed Issue/Pre-existing conditions
  - Administrative Costs
  - Out of Pocket Costs: Premiums, deductibles, copays, co-insurance, un-covered services
  - Premium and cost-sharing subsidies
  - Essential benefits
- What care to deliver to whom; what is to be subject to constrained optimization?
- What can we afford? How can we make care more efficient? How can health results be more equitable?
- How will care be organized and financed?

Questions?