**Chapter 1: U.S. Medical Care: An Uncertain Future**

This chapter introduces the student to the economic way of thinking as it relates to the study of the U.S. medical care system. After a brief summary of the historical development of medical care delivery and finance, the basics of economic modeling and analysis are addressed. The similarities and differences between medical care and other economic goods and services are also discussed. As a set of unifying themes providing focus and continuity throughout the book, ten guiding principles are introduced and defined.

**Chapter Outline**

a. Historical developments in the delivery of medical care

1. Post-war experience

2. Concern over high and rising spending

3. Changes in medical care delivery

b. Health economics defined

c. Ten key economic concepts

d. Summary and conclusions

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| Issues in Medical Care Delivery |
| * The Patient Protection and Affordable Care Act of 2010 * Spending Somebody Else’s Money |

**Chapter Objectives**

1. Understand the nature of the health care crisis in America.
2. Identify the important historical developments affecting health care delivery and finance in the U.S. system.
3. Identify and explain the major reasons for the high and rising cost of medical care.
4. Understand how the third-party payment mechanism and managed care affect health care delivery.
5. Understand the impact of the current healthcare reforms
6. Recognize the relevance of economics in studying health care issues.
7. Understand the aspects of medical care that contribute to its uniqueness as a commodity.

**Teaching Suggestions**

1. Get a copy of the survey from Victor R. Fuchs, “Economics, Values, and Health Care Reform,” *American Economic Review* 86(1), March 1996, 1-24. Ask your students to answer the survey and tabulate the answers. Compare their answers with those of the economists who answered the survey originally. This is a good way to check the pulse of your class. The ensuing discussion can be a good way to introduce many of the topics covered in the course.
2. National media attention has focused on the problems of the medical care sector periodically in recent years. The “crisis” in medical care is well documented. Discuss the various meanings of the term “crisis.” Students will have some interesting perspectives on this issue.
3. It is a good idea to discuss the use of the Internet as a research tool. It is important that students be able to discern good sources from bad. The Internet is full of both. That is the purpose of the Internet exercise in my class. Students join a ListServ or eavesdrop on a newsgroup to get some idea how to judge the quality of the information available in cyberspace. There are literally thousands of forums to join. Many of my students begin their electronic discussions with DejaNews, a leading site for Internet discussion groups. You can find it at http://w2.dejanews.com/.
4. If you like to emphasize the incentives created by our third-party payment mechanism, make sure you at least mention “Spending Somebody Else’s Money.” When people spend their own money they spend it differently than when they spend someone else’s money. Students will remember this example the entire semester and beyond.
5. Discuss the future of the ACA and current debate on new reform and its impact on access, quality, and cost.
6. Take the time to go over the 10 key economic concepts. A brief introduction helps develop continuity.

**Suggested Approaches to End-of-Chapter Questions**

1. A crisis is defined in the dictionary as a critical time or occasion, or even an emergency. Students will approach this question differently. At this early juncture many will be influenced by their own experience with the health care system. Those arguing that the U.S. has a health care crisis will likely cite the following: 1) rising costs and spending, 2) the changing demographics of the population, 3) the number of uninsured, and 4) health status comparisons with other developed countries. Those arguing against a health care crisis will likely argue that 1) even the uninsured have access to care through public hospitals and emergency rooms, 2) medical technology is more widely available in the U.S. than anywhere else in the world, and 3) confounding factors make international comparisons suspect.
2. Medical care spending is absorbing an increasing share of national output, at least up until the last two or three years. Whether this recent slowing in the percentage share of GDP will continue is debatable (and a good structured discussion topic). The reasons for high and rising spending include 1) the increased use of medical technology, 2) rising medical input prices, 3) an aging population, 4) the cost of medical malpractice litigation, and most importantly, 5) the third-party payment mechanism.
3. Cost containment is an important policy goal since the health of the population is not the only important national goal. But cost containment may not be the most important national health care goal. The pursuit of cost-effective delivery makes more sense from an economic perspective. Other health care goals are improving access for the uninsured and quality for everyone. Note, however, these latter goals tend to drive up costs.
4. Scarcity in economics is the recognition that all resources are limited relative to wants that are unlimited in the aggregate. Scarcity forces us to make choices.
5. Unpredictability will be present in any complex system, and the health care market is certainly a complex system. Additionally, it contains contradictions, and there are some questions for which we simply don’t have the answers. Entry barriers include providers’ market power, inefficient provider systems, and in some areas, insufficient competition. Because a patient does not have medical knowledge, the patient must trust in the physician to act for the patient’s interest above his or her own interest. But many physicians today have diagnostic “side” businesses by which they earn money when they refer patients. Patients do not have the complex medical knowledge to make decisions, and so suffer from asymmetric information. Each insurer has its own system of payment, co-payment, life-time caps, and so on. All of these distortions appear in other markets, as well.

**Additional Questions for Discussion and Evaluation**

1. Outside of government itself, the largest industry in the United States is the health care industry. Over the past several decades, costs in the health care industry have been increasing at a much faster rate than the rate of inflation in general. Why? Cite relevant empirical evidence to support your answer.
2. How much do Americans spend on medical care? Why do they spend so much? How does US spending compare with that of other developed countries? Are we getting our money’s worth? Be somewhat specific.
3. How big is the role of the federal government in health care delivery and financing in the United States? How big should it be?
4. Give consumers more information, let them choose the best provider and the resulting competition will help to squeeze out costly waste and ineffective care. After all, markets work pretty well for other goods and services. The notion has some appeal, and a dose of market medicine would help some of what ails the nation's health-care system. But as a cure, the approach rests on the belief that health care is – in most respects – like any other product.
5. How is medical care different from other non-medical goods and services? How is it the same?
6. What are the essential characteristics that are required for a market to exist?
7. How can the medical marketplace be made more efficient?
8. Discuss the following: the demand for medical care is irregular, resulting primarily from the onset of an illness; there are widespread information problems; uncertainty is exceptionally problematic; there is a reliance on not-for-profit providers; and we pay for it with other people’s money.
9. The 1980s was characterized by a dramatic change in the way Americans paid for medical care—retrospective to prospective. Define the two concepts and explain how the way we pay affects the care we receive? [The two concepts are defined in the glossary. Retrospective payment establishes incentives to over-treat. Prospective payment creates incentives to withhold care. ]
10. Discuss the opportunity cost of health care in terms of education. Why do you suppose taxpayers are willing to invest in an inefficient health care system with excess hospital capacity, but unwilling to invest in an under-funded education system?
11. “Nobody spends other people’s money the way they spend their own money.” Comment on this statement.
12. The president’s health policy adviser Zeke Emanuel said the following about the US healthcare system in a November, 23, 2008, *Washington Post* article, “We have the most expensive system in the world per capita, but we lag behind many developed nations on virtually every health statistic.” Comment on the two parts of his statement. Provide evidence to support your answer.

***Multiple Choice***

1. Opportunity cost is a measure of

1. foregone opportunities.
2. value based on the alternative not chosen.
3. value in terms of the cost of production.
4. the difference between production cost and resource cost.
5. **both a and b.**

2. The opportunity cost of investing in a new lithotripter (a machine that pulverizes kidney stones with sound waves) is

1. defined by the dollar cost of the equipment.
2. the same for every health care provider.
3. measured by the difference between the expected revenues from selling the services of the lithotripter and the invoice cost of the machine.
4. **defined by the next best use of the money invested in the equipment.**
5. impossible to calculate.

3. The “invisible hand” using Adam Smith’s terminology refers to

1. government control of the market.
2. **market forces working through the price mechanism.**
3. the money supply that serves to keep the economy working smoothly.
4. the role of innovation in maintaining a steady rate of growth.
5. “behind-the-scenes” policy making to influence how markets allocate scarce resources.

4. According to recent public opinion polls, what percentage of Americans are satisfied with the quality of the medical care they receive?

1. 15 percent.
2. 40 percent.
3. 65 percent.
4. **70 percent.**
5. 90 percent.

5. Charging higher prices for one category of patients in order to provide free or subsidized care to another group is called

1. price discrimination.
2. **cost-shifting.**
3. categorical costing.
4. reprehensible and unethical.
5. creative accounting.

6. According to economic theory what is the optimal percentage of GDP to be spent on medical care?

1. 6 percent.
2. 8 percent.
3. 10 percent.
4. 12 percent.
5. **There is no widely-accepted way to determine the optimal percentage.**

7. The 1974 federal legislation that exempted employers from certain state laws governing health insurance was

1. COBRA
2. **ERISA**
3. CON
4. HIPAA
5. SCHIP

8. Which of the following statements is based on positive analysis?

1. Individuals without health insurance have less access to physicians’ services than those who have health insurance.
2. The high cost of health insurance places U.S. firms at a competitive disadvantage with their foreign competitors.
3. Employers should be required to provide health insurance for all full-time workers and their dependents.
4. none of the above.
5. **Both a and b.**

9. Economists use the term “marginal” to describe costs and benefits

1. that are minimal and hardly worth noting.
2. **that are incremental and thus relevant to decision making.**
3. that are noteworthy but not the most important.
4. whose importance can be minimized through hard work.
5. none of the above.

10. Self-insurance refers to: the practice of setting aside funds to pay for medical care expenses instead of paying premiums to an insurance company. Approximately, \_\_\_\_\_\_\_ of all employees who participate in group insurance plans work for firms that self-insure.

1. starting one’s own insurance company
2. buying insurance from a not for profit entity
3. **setting aside fund to pay for medical care expenses instead of buying insurance**
4. none of these
5. both a and b

11. Which of the following is not a characteristic that makes medical care different from other commodities?

1. Demand for medical care is irregular.
2. Sellers have more information than buyers.
3. Third-party payers abound.
4. **For-profit providers play a major role in delivering medical care.**
5. The transaction itself if filled with uncertainty.

***Structured Discussion:***

1. *Resolved*: The United States system of health care delivery is in a state of crisis.

2. *Resolved*: The recent slowing of health care spending as a share of gross domestic product will continue. In other words, the relative size of the health care sector has reached a natural limit.

**Appendix 1A: The Medical Care Price Index**

This appendix demonstrates the use of price indexes to measure price changes. Caution is advised in interpreting changes in fixed-weight indexes, such as the Consumer Price Index (CPI) and the Medical Care Price Index (MCPI), as a measure of inflation. Problems in using the MCPI to measure medical inflation are discussed, including what to measure, how to account for quality improvements, and how to incorporate new products into the index.

**Appendix Objectives**

1. Summarize the issues involved in measuring price changes with price indexes.
2. Describe the use of the medical care price index in measuring changes in medical care prices.
3. Specify alternatives for measuring price changes.

**Appendix Outline**

a. Measuring price changes with index numbers

b. Medical care price index

c. Problems with using a fixed-weight index as a measure of inflation

d. Measuring inputs instead of outcomes

e. Measuring quality changes

f. Accounting for new products

g. Other problems

h. Alternative methods to measure medical care inflation

i. Summary and conclusions