Health Care Economics

David M. Cutler
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One of the most contentious economic issues of our day

Is the Affordable Care Act good policy?

- Good for health?
- Good for the economy?

“Since March of 2010, the American people have had to suffer under the incredible economic burden of the Affordable Care Act—Obamacare.”

“Hillary will stand up to Republican-led attacks on this landmark law—and build on its success to bring the promise of affordable health care to more people.”
Public’s View Of The Law Remains Divided

As you may know, a health reform bill was signed into law in 2010. Given what you know about the health reform law, do you have a generally favorable or generally unfavorable opinion of it?

SOURCE: Kaiser Family Foundation Health Tracking Polls
What is reform about?

- Need to understand health care.

Outline

1. The economics of health care
2. What is health care reform about?
Takeaway points

1. Market failures are rampant in health care
   - The government must be, and is, involved.

2. Medical care delivery is extremely inefficient
   - Different theories about why

3. Financing care for the poor is a major issue
   - It’s an exercise in optimal taxation.
Understanding Medical Systems

Standard Economic Markets

Buyer (Patient)  Money  Seller (Provider)

Services
The Medical Care System

Insurer

Patient

Provider

Financing rules

Payment rules

Access rules
Economic Issues I

1. Financing: paying for coverage
   - Some people are too poor to afford medical care on their own.
   - How can they get insurance?
   - This is really a question in taxation.
Health care reform: cover the uninsured through income-based subsidies

<table>
<thead>
<tr>
<th>Income range (% of poverty)</th>
<th>Family Payment (% of Income)</th>
<th>Typical payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;133% (Medicaid)</td>
<td>0%</td>
<td>$0</td>
</tr>
<tr>
<td>133-150%</td>
<td>3-4%</td>
<td>$1,100</td>
</tr>
<tr>
<td>...</td>
<td></td>
<td></td>
</tr>
<tr>
<td>300-400%</td>
<td>9.5%</td>
<td>$7,400</td>
</tr>
</tbody>
</table>

Note: The poverty line is about $12,000 for an individual and $24,000 for a family of 4.
Notes: The financing system has both income and substitution effects.
Equality vs. Efficiency

**Efficiency**
- Is the marginal tax rate too high (Pr. Mankiw)?
- Is the overall cost too high (Pr. Feldstein)?

**Equality**
- How much is it worth to save 20,000 people from dying each year (Pr. Cutler)?
What has happened?

After an awful start, coverage has gone reasonably well.

There have not been large, adverse labor supply effects.
Economic Issues II

2. Access rules and the demand side
3. Payment and the supply side

What care do people receive?

Diagram:
- Patient
- Provider
- Insurer

Payment rules
Access rules
Market failures are rampant in medicine

Common Assumption
- People know what they need.
- People have full information.
- Peoples’ actions affect only themselves.
- There is full (“perfect”) competition.

Medical Care
- Need is unpredictable
- People are poorly informed (who is the best doctor to treat cancer?)
- There are many externalities (Ebola)
- We are unwilling to deny care to those without (ERs)
- Competition is limited (licensing, FDA)

→ Insurance is valuable.
Insurance is valuable… But

- Because people do not pay for all the care they receive and providers are paid well, more care is provided than is optimal.
  - Moral hazard
How many annual MRIs should a person receive in the remission phase of cancer?

![Diagram showing supply curve and deadweight loss](image)

- Price
- Medical care
- Cost to patient
- Deadweight Loss
- Q*
- Q'
The policy issue

- Some moral hazard is valuable (because insurance is valuable) and unavoidable.

- But there might be too much.
  - Money paid as wages is taxed to employees. Money paid as health insurance is not.

- $1 cash $\rightarrow$ 30% marginal tax rate $\rightarrow$ $.70 of HI
- $1$ to HI $\rightarrow$ $\ldots$ $\rightarrow$ $1$ of HI
Economists: limit the exclusion of employer-provided health benefits from taxation

- Reform I: premiums of high cost plans are taxed, but the tax is put off a number of years (2019) and only some plans are taxed (‘Cadillac tax’)

- *Is this too little reform?*
Economists: limit the exclusion of employer-provided health benefits from taxation

- Reform II: allow pre-tax contributions for cost sharing in high deductible health plans

- Evidence on the effectiveness of changes in use is mixed.
  - People eliminate valuable as well as less valuable care
The supply side and payments

Doctors are paid for doing more stuff, especially more intensive stuff.

Doctors fear being sued for malpractice.
The result: people don’t get the right care
Economists: change the incentives that encourage excessive care

Reform:
- Large investment in health IT
- Numerous changes in Medicare payments designed to reward value of care, not volume of care

Current (cancer)
- Oncologist consult
- Outpatient MRI(s)
- Hospital stay
- Follow-up visits
- Medications
- Radiation

Alternative
- One price for treating the cancer (180 days of all services)
Costs: Medical spending increases have been very low in recent years

Annual real, per capita medical spending growth (1970-2014)

Source: Authors’ calculations based on data from the Bureau of Economic Analysis and the Centers for Medicare and Medicaid Services
Where Does This Leave One?

The Left

- Reform will cover people and has efficiency-improving changes
- If it doesn’t work, we need a Canadian-style system

The Right

- Reform is weak on the most meaningful component of reform – the tax treatment of HI
- The marginal tax rates created by reform are too big
- We can’t afford the coverage increase now