Medical Economics

Brief summary of economic principles

- People act with enlightened self interest
- Money is a medium of exchange to allow people to act within the general economy
- The value of money is a reflection of the value of the goods and services produced within an economy and the money supply
- Inflation is a state of reduced value of a monetary unit (dollar)

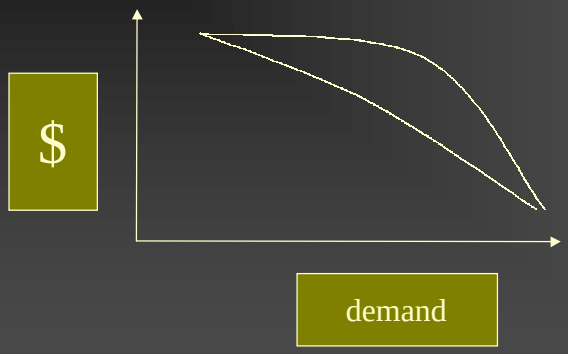
Economic principles

- In a market economy the producer of a good or service values his work at a particular price.
  - This price is only good if a consumer is willing to pay that price for that good.
  - “market pricing”
- Price elasticity

Price elasticity

- The supply and demand curve describes how the demand for an item is changed by changes in price.
  - Some items are very elastic and others are not

Supply and demand curves



Market distortions

- Monopolies and trusts
- Regulations
- Third party purchasing

Insurance system

- Initially began as a way to distribute risks among a group.
- Social contract
- Became a benefit for workers and universally expected
- What are the motivating factors in the insurance system?

Insurance

- Patient – Hopefully motivated to stay well
  - Patients want to have greater well being
- Doctor – motivated to provide care
  - Want to avoid risk (liability)
- Insurance companies – motivated to provide a system of payment to make sure care is delivered to enhance health

Finite pool of assets committed to healthcare

- What is our social contract?
- How large should your share be?
- How much should a service cost?
- What is the value of the service?

Enlightened self interest

- Suggest people look out for their own monetary interests.
- Doctors would produce excess care
- Patients would seek unneeded care
- Insurance companies try to reduce expenses

Market distortion

- Insurance companies guaranteed a fee for a service which was up to 70% of the highest fees for the region.
- If insurance companies had higher than expected costs they increased premiums
  - Insurance ratings
- Doctors were the decision makers in ordering care
- Patients used someone else's money

Insurance ratings

- Based on prior experience of a population
- High cost leads to high premiums
- What can increase the cost of care?
  - Lifestyle
  - Geographic and demographic factors
  - Practice patterns of the providers
  - Health seeking behavior of the patients

Couple of facts

- Geographic variances in procedures were found. This implied that the decision makers in one region might be ordering unnecessary tests and treatments
- Idea of moral hazard – using someone else's money outside of a true market system
  - Patients do it
  - Doctors do it

RAND study

- Premise is that health care acts on a supply and demand or price demand curve
- Implication- the more an individual has to pay of his own resources the less care they will consume

Rand study

- Patients with different co-pays were compared
  - The patients with the highest co-pays used the fewest resources

In the 60’ s and 70’s

- Fee for service was bolstered by medicaid and medicare
  - Specifically meant to provide treatment for those without resources
- This meant a ‘hidden’ demand for services came out into the open
  - The increased demand resulted in higher prices
  - Was this appropriate?

HMO's

- HMO's philosophy was stated that by keeping people healthy costs would go down
  - Provide preventive services and limit expensive terminal services
- One element of pricing is the value of the risk that an MD takes in treating a patient
  - Liability costs
- HMO's basically limited care by second guessing the physician
  - Few MD's joined due to unequal distribution of risks

HMO's and ERISA

- Congress enacted legislation to limit the liability of HMO's and employer administered health plans in order to encourage the growth of HMO's and managed care.
  - 1974 law basically said you can't sue them for their decisions

1980's

- By the 1980's the industrial health complex was dependent on federal dollars in form of medicare and medicaid.
  - Health care financing administration (HCFA)
  - HCFA sets regulations for healthcare
    - Determine how many beds, resident MDs, Medical students etc
    - Determine what must be in the medical record for billing
    - Determine the payment system for medicare / medicaid
  - Diagnosis related groups (DRG's)

DRG's

- Prospective payment according to diagnosis
  - Pays a set amount
  - If you come in under that amount you make money
- Problem is how do you determine costs?
- Which disorders do you pay for?

What are the roles of Government in healthcare?

- Payer
- Regulator
  - Certificate of Need
  - Licensure
  - Price control
  - Quality control
  - Drug approval

Politics and healthcare

- Important part of the national budget as well as the gross national product
- Currently we are spending close to 15% of the value of all the goods and services produced in the US on healthcare
  - More than other countries
  - Are we getting value for it?

Disparity in the system (over 40 million people do not have insurance)

- Is it fair that some people do not have health insurance?
- When an MD treats a patient who is unable to pay how does he make a living?
- Is that fair?
- How do other countries deal with it?