

# Contents

Preface xv

## PART I: BASIC ECONOMIC TOOLS

### CHAPTER 1 Introduction 1

- The Relevance of Health Economics 2
- Economic Methods and Examples of Analysis 9
  - ◆ *Feature: Who Are Health Economists and What Do They Do?* 11
- Does Economics Apply to Health and Health Care? 12
- Is Health Care Different? 14
- Conclusions 18
- Summary 19
- Discussion Questions 19
- Exercises 20

### CHAPTER 2 Microeconomic Tools for Health Economics 21

- Scarcity and the Production Possibilities Frontier 22
- Practice with Supply and Demand 24
- Functions and Curves 28
- Consumer Behavior Theory: Ideas Behind the Demand Curve 30
- Individual and Market Demands 35
- Elasticities 36
- Production and Market Supply 38
- The Firm Supply Curve Under Perfect Competition 45
- Monopoly 47
- Welfare Losses 49
- The Edgeworth Box 50
- Conclusions 51
- Summary 51
- Discussion Questions 53



Exercises 53

APPENDIX: Discounting 55

### CHAPTER 3 Statistical Tools for Health Economics 57

Hypothesis Testing 58

Difference of Means 59

Regression Analysis 63

◆ *Feature: The Treatment of Income in Survey Research* 64

Multiple Regression Analysis 68

The Identification Problem 71

Discrete Choice Analysis 72

Statistical Inference in the Sciences and Social Sciences 74

Conclusions 74

Summary 75

Discussion Questions 75

Exercises 76

## PART II: SUPPLY AND DEMAND

### CHAPTER 4 The Production of Health 79

The Production Function of Health 79

On the Historical Role of Medicine and Health Care 82

◆ *Feature: Tuberculosis and the Magic Mountain* 85

The Production of Health in the Modern Day 88

On the Role of Schooling 96

Conclusions 98

Summary 98

Discussion Questions 99

Exercises 100

### CHAPTER 5 Demand for Health Capital 101

The Demand for Health 102

Discounting and the Evaluation of Health Care Investments 103

Labor-Leisure Trade-offs 104

The Investment/Consumption Aspects of Health 107

Investment Over Time 109

The Demand for Health Capital 109

Changes in Equilibrium: Age, Wage, and Education 111

Empirical Analyses Using Grossman's Model 113

◆ *Feature: Rational Addiction—An Adaptation of the Demand for Health* 114

An Integrated Framework for the Grossman Model 116

Conclusions 120



Summary	120
Discussion Questions	121
Exercises	121

## **CHAPTER 6 Consumer Choice and Demand 123**

Applying the Traditional Model	124
Two Additional Demand Shifters—Time and Coinsurance	129
Issues in Measuring Health Care Demand	132
Empirical Measurements of Demand Elasticities	135
Impacts of Insurance on Aggregate Expenditures	143
Conclusions	143
Summary	143
Discussion Questions	145
Exercises	145

## **PART III: INFORMATION**

## **CHAPTER 7 Asymmetric Information and Agency 147**

Overview of Information Issues	148
Asymmetric Information	149
◆ <i>Feature: The Extent of Consumer Knowledge</i>	150
Application of the Lemons Principle: Health Insurance	153
◆ <i>Feature: The Benefits of Asymmetric Information</i>	156
The Agency Relationship	156
◆ <i>Feature: Agency Problems in Other Fields</i>	157
Consumer Information, Prices, and Quality	160
◆ <i>Feature: Consumer Behavior and Price Information</i>	162
Conclusions	164
Summary	164
Discussion Questions	165
Exercises	166

## **CHAPTER 8 Imperfect Agency and Supplier-Induced Demand 167**

The Need to Consider SID	167
A History of SID	168
A Common Representation of SID	170
Other Models of SID	172
The Identification Problem and the Evidence on SID	178
Evaluation of SID	180
Summary	181
Discussion Questions	182
Exercises	182



**CHAPTER 9 Health, Health Care, and Advertising 184**

A Background on Advertising by Health Care Firms 185

The Firm's Optimal Level of Advertising 186

The Effects of Advertising on the Health Care Sector 193

Advertising and Health: The Case of Cigarettes 200

◆ *Feature: Old Joe Ads* 206

The Effect of Price on Cigarette Consumption 206

◆ *Feature: Anti-smoking Sentiment* 207

Conclusions 209

Summary 210

Discussion Questions 210

Exercises 211

**CHAPTER 10 Physician Uncertainty and Small Area Variations 213**

The Small Area Variations Phenomenon 214

The Physician Practice Style Hypothesis 215

◆ *Feature: Small Area Variations and the Diffusion of Medical Technological Information* 219

SAV and Inappropriate Care 220

◆ *Feature: Clinical Decision Making—Patient Preferences and Prostatectomy* 221

The Cost of Undesired Variations 223

Conclusions 226

Summary 226

Discussion Questions 227

Exercises 228

**PART IV: INSURANCE AND ORGANIZATION OF HEALTH PROVIDERS****CHAPTER 11 Insurance 229**

Risk and Insurance 231

The Demand for Insurance 235

The Supply of Insurance 238

Demand for Insurance: The Case of Moral Hazard 241

Health Insurance and the Efficient Allocation of Resources 244

Loading Costs and the Behavior of Insurance Firms 247

Employer Provision of Health Insurance and the Tax System 250

Employer-Based Health Insurance and Job Mobility 252

The Market for Insurance—Blue Cross and Commercial Insurers 254

The Uninsured—An Analytical Framework 258

Conclusions 261

Summary 262



Discussion Questions 263

Exercises 264

**CHAPTER 12 Managed Care and Health Maintenance  
Organizations (HMOs) 266**

Managed Care 267

HMOs and Their History 269

Development and Growth of HMOs—Why Has It Taken So Long? 271

◆ *Feature: Organized Medicine and Prepaid Group Practice* 274

Federal Policy Toward Managed Care 275

Demand and Supply of HMOs 276

Are HMO Costs Lower? 280

HMOs and Growth in Spending 283

Quality of Care in HMOs 284

Competitive Effects of HMOs and PPOs 286

Conclusions 289

Summary 289

Discussion Questions 290

Exercises 291

**PART V: TECHNOLOGY**

**CHAPTER 13 The Production and Cost of Health Care 292**

Substitution Between Health Care Inputs 293

The Cost Function and Economies of Scale and Scope 297

Empirical Cost Function Studies 303

The Survival Analysis Approach 308

Technical and Allocative Inefficiency 311

Conclusion: What Has Been Learned About the Production  
and Cost of Health Care? 317

Summary 318

Discussion Questions 319

Exercises 319

**CHAPTER 14 Technology 321**

Technological Change and Costs 321

Insurance, Technology, and Inflation: Looking Toward the Future 330

On the Diffusion of New Health Care Technologies 331

Conclusions 334

Summary 334

Discussion Questions 335

Exercises 335



**PART VI: LABOR****CHAPTER 15 Labor Markets and Professional Training 337**

- The Importance of Labor in the Health Care Sector 338
- The Demand for and Supply of Health Care Labor 338
- The Human Capital Theory of Investment in Education 342
- Factor Productivity and Substitution Between Factors 346
- Health Manpower Availability 348
- Manpower Planning and the Meaning of Shortages 350
  - ◆ *Feature: Work Force Planning Versus the Power of Markets* 353
  - ◆ *Feature: Are Nursing Markets Monopsonistic?* 359
- Conclusions 359
- Summary 360
- Discussion Questions 360
- Exercises 361

**CHAPTER 16 The Training and Practice of Physicians 363**

- Medical Education Issues and the Question of Control 364
- Licensure and Monopoly Rents 370
  - ◆ *Feature: A View from the Medical Profession* 373
- Physician Pricing and Behavior 375
  - ◆ *Feature: Price Discrimination by Physicians Under a Charity Hypothesis* 377
- Geographic Location of Physicians 383
- Conclusions 387
- Summary 388
- Discussion Questions 389
- Exercises 390

**PART VII: HOSPITALS AND NURSING HOMES****CHAPTER 17 Hospitals and Long-Term Care 391**

- Background and Overview of Hospitals 391
- Hospital Utilization and Costs 396
  - ◆ *Feature: Game Theory and the Medical Arms Race (MAR)* 398
- Long-Term Care 401
- Conclusions 406
- Summary 406
- Discussion Questions 407
- Exercises 408



**CHAPTER 18 The Role of Nonprofit Firms 409**

- An Introduction to Nonprofits 409
- Why Nonprofits Exist and Why They Are Prevalent in Health Care 410
- Models of Nonprofit Hospital Behavior 418
- The Relative Efficiency of Nonprofits versus For-Profits 427
- ◆ *Feature: Why Are RNs' Wages Higher in Nonprofit Nursing Homes?* 431
- Conclusions 432
- Summary 433
- Discussion Questions 434
- Exercises 435

**PART VIII: SOCIAL INSURANCE AND HEALTH SYSTEM REFORM****CHAPTER 19 Government Intervention in Health Care Markets and an Introduction to Regulation 436**

- Economic Rationale for Government Intervention 437
- Government Involvement in Health Care Markets 441
- Introduction to Regulation 446
- Regulation of the Hospital Sector 448
- Prospective Payment 452
- Competitive Strategies 460
- ◆ *Feature: Do the Laws of Demand and Supply Apply to Health Care Markets?* 466
- Conclusions 467
- Summary 467
- Discussion Questions 468
- Exercises 469

**CHAPTER 20 Equity, Efficiency, and Need 470**

- Efficiency and Competitive Markets 471
- Deviations from the Competitive Model in the Health Care Sector 476
- Promoting Competition in the Health Care Sector 478
- An Economic Efficiency Rationale for Social Programs in Health Care Based on Externalities 479
- Need and Need-Based Distributions 481
- Economic Criticisms of Need-Based Distributions 485
- Horizontal Equity and Need 486
- Theories of Social Justice 488
- Conclusions 491
- Summary 492
- Discussion Questions 493
- Exercises 493



**CHAPTER 21 Social Insurance 495**

- Social Insurance Policies and Social Programs 495
- Historical Roots of Social Insurance 498
- Medicare and Medicaid in the United States 501
- The Effects of Medicare and Medicaid 503
- National Health Insurance 510
- Conclusions 513
- Summary 513
- Discussion Questions 514
- Exercises 514

**CHAPTER 22 Comparative Health Care Systems 515**

- Criticisms of the American Health Care System 515
- Contemporary Health Care Systems 517
- National Health Programs: Three Examples 519
- The Canadian Health Care System 527
- ◆ *Feature: How Is Health Care "Rationed" in Canada?* 533
- Differences in Health Care Spending Across Countries 534
- Conclusions 537
- Summary 537
- Discussion Questions 538
- Exercises 539

**CHAPTER 23 Health System Reform 541**

- International Perspective: Health System Reform in Selected Countries 542
- Financing 544
- Insurance Issues 554
- Conclusions 560
- Summary 560
- Discussion Questions 560
- Exercises 561

**PART IX: POLICY ISSUES AND ANALYSES****CHAPTER 24 Cost-Benefit Analysis and Applications to Health Care 562**

- ◆ *Feature: Is the United States Spending Too Much on AIDS Research?* 563
- Cost-Benefit Analysis: Basic Principles 563
- The Valuation of Benefits and Costs 568
- Cost-Benefit Analysis in Health Care 572
- Quality-Adjusted Life Years (QALYs) 575
- Cost-Effectiveness Analysis 578



Conclusions	580
Summary	580
Discussion Questions	581
Exercises	582

## **CHAPTER 25 Economics of Mental Health and Substance Abuse 583**

Incidence of Ailments	584
Nature of the Ailments and Treatments	586
Offset Effects	588
Treatment Supply	589
Treatment Demand	590
Financing	591
Conclusions	594
Summary	594
Discussion Questions	595
Exercises	595

*Glossary* 597

*References* 607

*Name Index* 643

*Subject Index* 651