

Importance of health care within the economic market



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The study of economics allows insight into systems that regulate populations of people. The two main sub fields of this discipline are microeconomics and macroeconomics. Microeconomics focuses on the behavior of individuals and firms within markets. Macroeconomics on the other hand, is concerned with large-scale issues related to markets as a whole. (Krugman, P. & Wells, R., 2018). Healthcare, as a system, has become one of the largest industries in the world, according to Johns Hopkins (The Economic Impact of the John Hopkins Healthcare System, 2015), and is projected to continue growing exponentially. This fact is expressed in the growing percentage of public and private health expenditure in relation to the Gross Domestic Product. In other words, the growth rate of health spending is higher than the rate of GDP growth (Economic, 2015). Adding more years to each individual's lifetime means that, on the whole, people will have more years during which to become ill. This means more hospital stays and more prescription drugs being consumed. The health system, the set of institutions that care for the health of citizens, is of growing importance in economic systems.

Economic science is equipped with analytical tools for the allocation of resources that provide answers and solutions to problems of accessibility and efficiency in the production and distribution of goods and services (Krugman, 2018). However, the economic concepts of demand, supply, production and distribution take on a special meaning when they refer to goods and services intended for the health of human beings. The United States, according to the OECD, is currently spending twice as much on healthcare per capita as every other advanced industrial nation (Economic,

2015), which negates the idea that healthcare is functioning like a normal competitive market.

In most cases, situations that economists would call optimal for an ordinary material good, would be considered socially unacceptable when referring to health. Decisions about how to allocate doctors' and nurses' labor, whether to build a new hospital, whether to pass a new law, how much research to put into a new drug and once the research has been completed, decisions about how to price the drug, are made almost solely based on questions related to economic principles. Where will labor be most valuable? How can we find the most cost-effective materials for the hospital? How much did it cost to develop this drug, and what kind of long-term returns can we expect from it? People asking these, and other healthcare-related questions, will turn to those with knowledge of economics for the answers. With exponential growth expected in the global healthcare industry (Economic, 2015), being knowledgeable of the issues facing the industry and familiar with the players involved will prove invaluable.

There are various indicators used when discussing a healthcare system; access, quality of care, and economic efficiency (Raghupathi, W. & Raghupathi, V., 2014). The indicator of most importance to the researcher or the government directly determines their views on the functionality of the system. The indicator that researchers are most focused on is determined by their views on healthcare as a right or a commodity. If healthcare is viewed as a commodity, then quality and economic efficiency become the most important indicators of system functionality. If healthcare is viewed as a right, then access and quality become the most important indicators of the <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

systems functionality. There is no way to balance economic efficiency, access and quality in a healthcare market. One or possibly two of the indicators must be sacrificed.

The balance of access, quality and economic efficiency in a healthcare system is determined by the identity and goals of the price-setters (Health, n. d.). Healthcare does not follow a normal free-market structure due to quasi-monopolistic competition which cause imperfect knowledge on the part of medical consumers. In a free-market, this structure allows for healthcare providers to become price-setters, and bypass a competitive market. When healthcare providers are price-setters, the price will be set high. Which, in turn, will lower access, create higher quality due to competition for consumers, and be economically inefficient. However, if government controls healthcare financing, healthcare providers either take the price that the government offers, or do not receive payment. This allows government to do the price setting. When a government controls healthcare financing and the provision of healthcare, it will tend to set prices as close to cost as possible (Raghupathi, 2014). Low price-setting can lower quality and create waitlist. But if the government only controls healthcare financing and not held responsible for the provision of healthcare, the government will tend to set prices higher by forced negotiations with healthcare providers. High price-setting will increase quality through competition, ensure access, but the system will be economically inefficient.

The study of healthcare contains many unique challenges. Consumers must rely on doctors to tell them what their preferences are. Consumers rarely directly pay for their own care, and rely on either insurance companies or the <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

government for payment. Pharmaceutical companies must rely on the medical community as their agents, which cause them to spend billions of dollars on advertising (Economic, 2015). All of these relationships can which lead to a lack of knowledge on the part of one party or the other, and allows them to have more power when negotiating. It is close to impossible for healthcare financiers to know the real cost of healthcare, and thus makes it possible for healthcare providers to increase the total price of healthcare, creating artificially increase expenditures (Economic, 2015). The provision of healthcare also provides further dilemmas for the study of the healthcare as a market.

In a balanced market, services are provided for self-interested reasons-to make money, but many healthcare professionals argue that they enter into practice out of more altruistic purposes (Raghuputhi, 2014). For example look at Doctors Without Borders, Mercy Ships, and other examples of low income healthcare offices that only cater to low income families. This makes the supply of doctors difficult to examine as a mere function of price determining quantity. To this end, it can be assumed that a small number of medical professionals will enter into practice at cost, but to provide enough medical professionals for an entire population, price will play a major role. In the study of economics, competition is believed to create higher quality goods, and lower price. (Krugman, 2018)

In perfect competition, firms must compete with each other, which drives price downward in an attempt to control a larger share of the market. In addition, the quality of goods is increased in the same attempt to control a larger share of the market. Furthermore, competition leads employees to try <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

harder to distinguish themselves from other employees, which can increase experience, education, and gives motivation for improving quality. However, due to the unique nature of the healthcare system, and all of its asymmetrical information, competition will not decrease price. This is not an assumption about the system but a conclusion arrived at by examining the healthcare market.

It is also assumed that the life expectancy in a given country is a function of the quality of care, the access to care, and life style choices (Raghupathi, 2014). Life expectancy is increased as quality and access increase. However, life expectancies also vary depending on diet and other lifestyle choices that are not easily identified, but have an overall effect. The last assumption pertains to demand. There is a theoretically set demand for any given ailment, being the total number of cases of the population that has this ailment. If 100 people have cancer, the demand for cancer treatment will be 100 units at any price. Actual demand for healthcare may never fully meet this theoretical demand because of patient preferences (Health, n. d.). Consider how some patients do not seek treatment for various reasons, but the theoretical demand still exists.

Generally there is only one hospital in any given region, which gives hospitals regional monopolies, allowing providers of healthcare to become price-setters. Hospitals do not compete directly with one another; consumers simply choose the hospital that is closest to them or included in their healthcare plan. Furthermore, hospitals and physicians, being self-interested, try to maximize their profits, but there is little competition in the region to keep prices low. Increasing profits for hospitals can be accomplished by <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

raising the prices of routine medical treatment (1 Tylenol pill costing \$50 at the hospital I work at for example). Another way is by specializing treatment and technology in certain fields that will attract consumers from other markets. For example, while hospitalized, a patient is charged the \$50 for one dose of Tylenol, which outside the hospital cost less than \$1. The patient is unable to leave the hospital to purchase the medication for physical reasons, and laws further prohibit the patient from doing so, therefore, the hospital is given monopoly control over the price of the Tylenol.

Hospitals can further increase their profits by specializing in certain fields that will attract consumers from other regions, such as a hospital specializing in the treatment of cancer. Patients will be willing to travel longer distances to receive specialized, higher quality treatments in non-emergency, complicated situations; which increases the share of the healthcare market for the hospital in those specialized fields (Health, n. d.). This second type of profit seeking leads to competition between hospitals; which increases the ability to receive higher quality treatment, but drives price upward. Newer technologies often cost more to purchase and use, and because the demand for one hospital becomes higher than for another, the hospital with higher demand is able to set prices even higher (Health, n. d.) Nike, for example, can charge more for their shoes than other shoe companies because the demand for Nike is higher than other shoe companies.

Consumers with insurance often do not know, or even care, about the price of treatment being higher at one hospital than another. They just want the best quality treatment available. Insurance companies are actually paying for the services, but their users are choosing where to receive treatment, <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

which decreases the ability of a higher price from deterring the consumption of the more expensive medical treatments (Raghupathi, 2014). This form of competition increases quality, but fails to drive price downward. Many insurance companies attempt to curb this from happening by requiring patients to go through their primary care physicians as a gatekeeper to other medical treatment, or by creating other limits. These limits, such as co-pays, can help moderate the overall expense for insurance companies, but do not limit the decisions of medical providers.

If an insurance company refuses to pay for a treatment at a certain location, they are likely to lose consumers. For example, if an insurance company refuses to allow its consumers to use the services of one hospital in a region because it costs more than another hospital, but another insurance company allows the use of that hospital by its consumers, there is motivation for consumers to switch insurance companies. Medical providers and insurance companies are both fully aware of this fact (Health, n. d.). Therefore, when negotiations take place between insurance companies and medical providers, the medical providers can always choose to refuse service to that insurance company if the price offered by the insurance company is lower than the provider wishes to receive. The insurance company is motivated to offer a higher price, or face losing consumers.

Insurance companies are competing directly with one another. This direct competition creates motivations for paying higher cost to medical providers than if there were only one insurance company. However, medical providers must have consumers, which means that they cannot refuse services to all insurance companies. Insurance companies with large consumer bases can
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negotiate lower prices with hospitals than the insurance companies with small consumer bases, because medical providers are more afraid of losing a large consumer base than a small consumer base (Health, n. d.). Hospitals do not have to worry what other hospitals are charging for their services, they only need to focus on the price that they can negotiate from insurance companies. This gives medical providers a quasi-monopolistic control over the price of medical treatment.

Decisions made by hospitals are often not based on competition with other hospitals, but on maximizing profits while meeting demand in a given region. When patients have the ability to choose between two hospitals, and competition exist between those hospitals, price is further inflated, despite the competition, by specializing in certain types of illness (Health, n. d.). This allows hospitals to be price-setters. High tech goods such as MRI machines and CT scanners can cost large amounts of money (I was unable to find actual prices because companies do not disclose this information to the public). If a low populated region buys a MRI unit and only performs a small number of scans with the machine each year, they must charge each patient more for the use of the machine than in a region where the machine is used more frequently. If ten patients are paying for a machine, it will cost more than if one thousand patients are paying for the machine.

Price-setting allows for high profits which stimulates higher quality of care, but decreases access to healthcare. This system is characterized by massive amounts of economic inefficiency, high quality, and decreased access. A socialized healthcare system, because of its knowledge about the cost, will set prices as close to cost as possible, which will decrease quality and create <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

waitlists. This system is characterized by guaranteed access to medical care; however waitlists create problems of access to care, increased economic efficiency, and decreased quality. A universal healthcare system, due to imperfect information of the part of the government, will have to negotiate the price for healthcare which allows medical providers to receive higher payments and stimulates higher quality of healthcare. This system is characterized by increased quality, full access with short wait periods, if any exist, and a moderate degree of economic inefficiency when compared to free market systems (Economic, 2015). This creates three different forms of price-setting, the free market system price is set by medical providers, the socialized system price is set by the government, and the universal system price is negotiated by medical providers and the government.

All three factors (access, quality, and economic efficiency) (Health, n. d.) must be discussed when evaluating any healthcare system. As seen with the models above, there is no way to balance all three factors perfectly. To guarantee high quality care, economic efficiency must be sacrificed. To guarantee access, governments must control price-setting, and price must be higher than the cost of the actual services provided. Economic efficiency and full access cannot be reached through a free-market system, even if a high quality system can be maintained.

How well a healthcare system is functioning is largely determined by the viewpoint of the person evaluating the system. If economic efficiency is most important, then a system that sets prices as close to cost as possible will be viewed as a superior to other systems. If quality is most important, then a free market system will be viewed as superior to the other systems. When <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

considering how to create healthcare policy, the effectiveness of these systems should be considered closely.

Coercive regulation is a special type of regulation in which any and all parties are subjected to forced regulation (Health, n. d.). This includes the well-known obligation to vaccinate children and mandatory inclusion to finance social security for employees and employers, whereas someone is forced to do something, or to finance it. Firmly planted within the center of healthcare and economics, public financing and public access are usually used to represent most of the current information seen in today's debates. The financing side is when part of the public funds obtained through taxes or issuance of public debt are used to finance the private provision of health services. Provision, or access, is when the state directly provides the services using infrastructure of its property and public employees (Economic, 2015).

Regarding the choice between public provision and private provision with public financing, the health provider must be financed to provide more at the lowest price. But there remains a certain ambiguity in trying to define what "more health" is. It is very difficult to measure the efficiency of health expenditure because it is very difficult to assess the product obtained. There is no current example today in which the budget of a country can finance all health services demanded. When a health service is offered to all who request it without taking into account the capacity of the offer, it can lead to the appearance of queues, delays of months in the provision of the service, allocation of service only to what can be expected as well as its denial to urgent ones (Raghupathi, 2014).

The US spent \$3.5 trillion—nearly 18% of GDP—on healthcare in 2017 (Economic, 2015). Healthcare spending has outpaced GDP growth for the last five decades. Understanding the incentives and structure of the healthcare industry can be daunting. Even President Trump said it, Healthcare is “an unbelievably complex subject.” (Liptak, 2017). Payment reform is slowly shifting incentives for health providers from volume to value. In contrast to most transactions with a seller and a buyer, healthcare services involve three parties: the patient, the provider, and the payer. Payers reimburse services providers deliver to patients. Payment models, the rules for how and when services are covered, are central to understanding the economic incentives healthcare providers face.

The bulk of care today is covered under a “fee for service” or FFS model. (Health, n. d.) Under FFS, the payers, being the healthcare insurance companies, pay healthcare providers for each individual service a patient receives; a lab test, a procedure, or an office visit, for example. The big concern with FFS is that it incentivizes providers to deliver higher volumes of care with less attention to quality or cost.

FFS is one payment model along a spectrum of alternatives. The other end of the spectrum is “capitation.” In lieu of reimbursing providers for each service they provide, capitation bundles all services together. Healthcare providers receive an annual risk-adjusted payment to cover any service that may be necessary for a patient. At the end of the year, providers keep whatever money remains. (Health, n. d.) Capitation models offer some hope of reducing costs by incentivizing value over volume. Capitation increases cost sensitivity, but it also runs the risk of incentivizing reductions in <https://assignbuster.com/importance-of-health-care-within-the-economic-market/>

valuable care. For example, a doctor could purposely postpone a routine procedure in order to reduce overall cost, effectively creating a gap between how much money the company believes a consumer is worth over how much the medical provider is actually charging.

When it comes to healthcare, consolidation of cost will bring tradeoffs. The upside is the potential for greater efficiency and coordination along the scale. In theory, larger healthcare systems can spread fixed costs over more patients and coordinate care across all providers a patient may need to see. The downside of consolidation is reduced competition, which is a driver of increased prices and fewer incentives for innovation. With less competition, providers can raise prices rather than improve efficiency when facing economic pressure. Reduced competition is especially problematic within the healthcare industry. With few existing incentives created based on quality, policy makers and market leaders will rely on the economic similarities to create new policy. Solutions that increase the quality of care may not immediately be embraced by healthcare systems. With large market shares and limited incentives to compete on quality, the system would continue along at its currently hap-hazardous state.

Prioritization of healthcare has systems in place that can directly be reflected by economic measurements. An ideal system would include the definition of "basic" health services that are universal for all citizens. It would include access of health services and use of instruments that reflect a higher result/cost ratio. These can be vaccinations and public information systems as well as advanced hospitals and modern machines. Another point would be to prioritize health services to individuals who are not able to finance them

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on their own. This is notably seen as sacrificing quality of care for the sake of efficiency. One of the most controversial, but a seemingly necessary measure, is to manage the prioritization of care for young people's diseases over those of old people's. It is important to consider where the result of a health action will have a longer effect (Raghupathi, 2014). It is difficult to compare quality and longevity of life to cost and money, healthcare and economics can be brought together to create shifts in policy.

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