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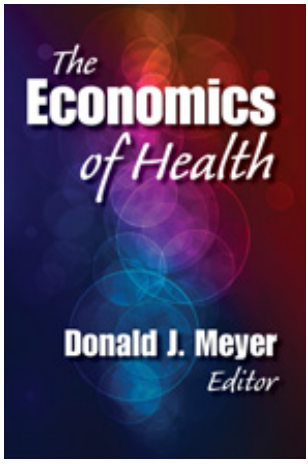
Introduction



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Introduction

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Securing good health is vitally important for each of us individually, as well as for our society as a whole. In fact, maintaining an acceptable level of health is necessary to adequately function in our daily lives. Health brings us happiness with the ability to feel good, to be pain-free, and to enjoy life. We yearn to have a rich, fulfilling life, and good health is the vehicle for being able to do so; it allows us to function productively in our jobs and reduces our number of sick days, which results in additional income and a higher standard of living.

The importance of good health extends to our overall economy as well. Health care makes up about 17 percent of our national economy and thus greatly affects our macroeconomy. Rising health care costs have presented challenges for the national budget, and incentive issues due to health uncertainty and asymmetric information have important market implications for our health economy. Furthermore, the obesity epidemic in our country is an alarming situation, contributing to deteriorating health, premature death, and escalating health care costs.

The passage and recent implementation of the Patient Protection and Affordable Care Act (ACA) has been extremely controversial. Important components of this historic act include the contentious personal mandate, the newly established state exchanges, and Medicaid expansion. Although the purpose of this book is not to critique the ACA, several chapters in this volume do evaluate how specific aspects of the ACA affect our economy.

When addressing or modeling health, economists typically posit a utility function $U(C,H)$, where consumers derive utility from consuming various goods and services (C), as well as from the level of health (H) they possess. Health can be thought of as an economic good that consumers work to acquire, similar to a stock or consumer durable, such as an automobile or a refrigerator. We need to model utility over

time and consider investments made to our health stock over our lifetimes. Utility maximization requires a trade-off between investing our scarce time and money into the acquisition of health or the consumption of other goods and services.

A significant aspect of the market for health is that the health level to be consumed *must* be produced by the same individual—that is, none of the health we wish to consume can be purchased as such in the marketplace. This is a very atypical situation in our economy; generally, consumers do not produce the good, they purchase it in the marketplace. It is similar to a family farmer who can eat only the vegetables that he grows himself. This leads to less specialization in production and more generalization.

Thus it becomes important to consider how one best produces an acceptable level of health for present and future consumption. Two significant inputs into the production of health are medical care and lifestyle choice or self-care. Doctor visits, medical procedures, and pharmaceuticals help improve our health; many of us receive these services through health insurance coverage that we purchase or obtain through our employers. Personal choices, such as the amount of physical exercise we get, our alcohol consumption, and calorie intake also influence our health. Other inputs that affect our health include education level, random health shocks, and the environment in which we live.

Uncertainty pervades over health determination, as our health status even one or two years into the future is highly unknown or uncertain. Our attitude toward the risk is very important in determining how we manage it. Buying insurance is one response to facing a random loss due to illness or disease. Health insurance is central to one's insurance portfolio, but other types of insurance can help in the events of becoming disabled, getting hurt on the job, or requiring assisted living. One can also invest in self-protection or self-insurance through a healthier lifestyle, including eating better food, exercising, and limiting alcohol and tobacco consumption.

Health markets are also heavily subject to situations of asymmetric information—when one party knows more information than another party about some health aspect. Adverse selection, nonrepresentative risk pools, and death spirals can result when individuals know more about their health risks than the insurance companies. Moral hazard, or a change in behavior upon having insurance, can cause people to

take on more health risks or overpurchase health insurance. The agency problem involves the challenge of hiring doctors or other health professionals to investigate our health issues and make decisions that are in our best interests.

This book contains six chapters that address various aspects of health. Charles E. Phelps begins the volume with "We Have Met Our Enemies and They Are Us." This provocative title refers to the fact that many of us in the United States do not make good lifestyle choices. Phelps cites a study that shows that poor choices regarding tobacco usage, eating, activity, and alcohol consumption make up the leading causes of death in the United States. He suggests working to improve the educational system, as education rates are generally positively correlated with making healthier lifestyle choices.

Phelps finds a direct relationship between medical spending and both income and life expectancy, but an inverse relation between medical spending and infant mortality. The extent to which the United States is a major outlier is surprising; we spend far more on medicine than any other country and have health results that are far from what our health expenditures would predict.

Chapter 3, "Do Medical Care and Self-Care Compete or Complement in Health Production?," by Donald J. Meyer, focuses on two of the primary input categories in one's health production function, medical care and self-care. He asks whether these two input types function more closely as substitutes or complements. Loosely speaking, are medical care and self-care more often used in combination with each other, or do individuals more likely choose one over the other? Meyer reviews arguments for each of these ideas, the complementarity relations that competing risk models indicate and the basic substitution effect based on relative prices and productivities.

Meyer first notes the two basic definitions in neoclassical production of two inputs having a complement or substitute relation. He then argues that this issue is more appropriately viewed in the context of significant uncertainty, a primary characteristic of the health setting. A common response to decision making under uncertainty is the attainment of market insurance and/or the practice of undertaking self-insurance or self-protection, two categories of self-care. Meyer reviews much of the literature in which researchers have debated whether these uncertainty responses are used more in a complementarity or substitution manner.

He recognizes and discusses the close link that exists between medical care and health insurance, thus enabling a more enriched definition of complements and substitutes between medical care and self-care in the health context. He then reviews three articles that have examined whether medical care and self-care are better described as complements or substitutes, and he offers his own opinions as well.

The next three chapters deal with some aspect of the Patient Protection and Affordable Care Act (ACA). John H. Goddeeris's chapter is entitled "Payment Reform and 'Bending the Curve.'" The "bending the curve" phrase has been attributed to President Barack Obama, who in 2009 said, "It is important for us to bend the cost curve . . . because the system we have right now is unsustainable . . ." This refers to the challenge of keeping health care costs under control and limiting the rate of annual increase of the costs. Goddeeris considers one such possible curve—health care costs as a percentage of gross domestic product—which has been growing consistently over the last 50 years and has reached a level of about 17 percent.

Goddeeris then addresses ways in which health care providers are paid, which he argues is a critical component of bending the curve. He examines aspects of paying for output rather than inputs, managed competition, and bundling by episode. Goddeeris argues for a more global payment method regarding some specific defined population versus a traditional fee-for-service plan. He discusses in detail the idea of an Accountable Care Organization and how this might better function in terms of incentives for receiving care and controlling costs.

Marcus Dillender's chapter is entitled "The Potential Effects of the Affordable Care Act on Disability Insurance and Workers' Compensation." Disability insurance covers people who are unable to work for over a year due to health concerns, and workers' compensation insurance pays medical costs for people who get injured while working on the job. These two types of insurance that relate to how the risk of health deterioration affects one's earning or income potential are sometimes overlooked by individuals who are concerned about addressing health risks in general.

The two main sections of the chapter examine basic program information for disability insurance and workers' compensation and how the ACA affects the likelihood of filing a claim for these types of insurance. Dillender also considers how the ACA may affect our health system

more generally, which can then indirectly spill over to the two types of insurance.

Edward C. Norton considers the issue of long-term care in his chapter, "The Economic Challenges of the The Community Living Assistance Services and Supports Act." The CLASS Act was a major component of the original ACA, but it ultimately was not supported and was struck from the act that passed in 2010. It would have created a market for long-term care with a number of interesting features. He reviews the expenditure needs of the typical elderly individual and notes that long-term care offers the greatest variance in out-of-pocket expense and thus is the riskiest issue facing the elderly.

Norton discusses why the CLASS Act was dropped from the ACA legislation, and he suggests that the proposed act faced many significant economic challenges. One challenge was adverse selection and moral hazard, present in all insurance markets but even more pronounced in the elderly long-term care market. Another challenge was inflation risk—claims made for long-term care insurance are often made decades into the future, when the purchasing power of your benefit amount is subject to years of inflationary erosion. Norton also suggests that the long-run viability of the program was in question due to the financial instability of funding the program long term.

Chapter 7, by M. Kate Bundorf, is entitled "The Role of Private Health Insurance in the Medicare Program." Bundorf introduces her topic by laying out the basic Medicare system in the United States. Parts A and B make up traditional Medicare originating in 1965 and cover hospital, physician, outpatient, and other standard forms of health care services. Part D was added under the Medicare Modernization Act of 2003 and adds outpatient prescription drug benefits.

Bundorf then focuses on two forms of private insurance that interact with the Medicare system. The first is Medicare Part C, or Medicare Advantage, which allows beneficiaries to enroll in a private plan that replaces traditional Medicare (parts A and B). The second is Medigap, a private policy that supplements existing Medicare. Medigap policies reduce deductibles and cover copays, reducing personal cost liability. This tends to accentuate moral hazard, as Bundorf notes. She evaluates the two different programs and how they have both increased Medicare spending over the years and then discusses how future Medicare reform may be differentially affected by the two plans.

Good health is a characteristic that is crucial to all of us individually and collectively as a country. The United States is challenged in its world ranking in health statistics, which is likely to become an even larger challenge as its population ages over the next few decades (Phelps discusses this in Chapter 2). Education in general appears to be an ally for good health and for becoming better informed about our health system, and it helps reduce uncertainty and aids in better decision making for all of us. The chapters in this volume contribute to this end and are indicative of the type of health research work that is needed.

The Economics of Health

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