Introduction to Health Policy

MHSA 8635
Health Politics and Policy

Health and Health Policy

- Definition of health
  - Traditional
  - World Health Organization
- Definition of health policy
  - Authoritative
  - Directed towards addressing one or more determinants of health
  - Influence decisions, behaviors, and/or actions of others

Relationship of Health Policy to Health

- Societal conceptualizations of health will vary from country to country
- The health policy “model”: Health policy → health determinants → health status

Typology (Source) of Health Policies

- Laws
  - aka statutory sources of health policy
  - Most enacted to accomplish defined social/health objectives (e.g. the Medicare program)
  - Mostly enacted at the federal and state levels by legislative branch(es) of government

Typology (Sources) of Health Policies

- Rules and regulations
  - aka administrative law
  - Guide the implementation of statutory sources of law
  - Responsibility of executive branch of government

- Operational decisions
  - Similar to administrative law in purpose (i.e. implementation of statutory law)
  - Considered to be less permanent than rules and regulations and not likely as subject to legal review
  - e.g. operational policies, protocols, procedures
Typology (Sources) of Health Policies
- Judicial decisions
  - Legal review of existing laws, both statutory and administrative, can result in the formulation of new policies
  - The role of the judicial branch in public policymaking is controversial due to the largely unelected (non-democratic) nature of most judicial positions.

Categories of Public Policy (Intent)
- Allocative Policy
  - Primary goal is to redistribute wealth and/or reallocate resources from one group to another for purposes of accomplishing one or more public policy objectives
  - e.g. Medicare, Medicaid, Social Security

Categories of Public Policy (Intent)
- Regulatory policy
  - Primary intent is to influence behaviors, actions, decisions of others to accomplish public policy objectives
  - Categories
    - Market entry (licensure regulations)
    - Rate/reimbursement (DRG's)
    - Quality (FDA, AHRQ)
    - Market conduct (antitrust)
    - Social (OSHA, EPA)

The Determinants of Health
- Individual determinants
  - Lifestyle determinants (e.g. diet, exercise, smoking, drug use)
  - Genetic determinants
- Health services determinants
  - Types of services (e.g. primary care)
  - Access to services (availability)
  - Quality of services

Specific Health Policy Effects on Health Determinants
- Environmental health policy
  - Policies to promote clean air, clean water, reduce poverty, reduce hazardous exposures, etc.
  - Desired effect of such policies is to mitigate the untoward effects of such environmental determinants and improve population health as a result
Specific Health Policy Effects on Health Determinants

- Individual health policy
  - Difficult to enact socially effective policy in this area to the individualistic nature of these determinants and the potential for encroachment on individual liberty
  - Policy focus has been in the area of funding research and education into specific determinants (e.g. smoking effects on health, obesity research)

Specific Health Policy Effects on Health Determinants

- Health services policy
  - Traditional policy objectives were to improve access to health services, especially to the most vulnerable (e.g. Medicare and Medicaid) and to increase service availability by subsidizing health services infrastructure (allocative policy)
  - Shift in policy goals over time to cost containment (regulatory policy)

Theories of Government Activity

- Why do governments intervene in private markets?
  - Public Interest Theory
  - Special Interest Theory (Economic)
- Public Interest Theory
  - Government intervenes in private markets to promote allocative efficiency and/or social equity
  - What causes markets to “fail”?

Markets and Allocative Efficiency

- Perfectly competitive markets typically come closest to achieving the goal of allocative efficiency.
- What is allocative efficiency and why is considered important enough for governmental action under PI theory?
- A market is allocatively efficient if it is producing the right goods for the right people at the right price.

How to Define Allocative Efficiency

- Recall that the consumer demand curve for any good has a negative slope. (prices must fall to induce greater consumption)
- Demand at any given price represents an individual consumer’s marginal benefit of consumption (MB).
Markets and Allocative Efficiency
- We can also define a demand curve for society’s preferences as a whole across all goods as the marginal social benefit (MSB) of consumption.

How to Define Allocative Efficiency
- Recall that the producer supply curve for any good slopes upwards with respect to market price (P). (price must increase to induce producer to increase supply)
- This reflects the fact that the marginal costs (MC) of production usually rise as output increases.
- Effects of economies of scale and scope of MC of production.

How to Define Allocative Efficiency
- At the societal level, the marginal social costs (MSC) of producing all goods will also increase as output increases due to the law of diminishing marginal productivity of inputs in the short term.

Markets and Allocative Efficiency
- It turns out that a competitive market equilibrium \((P_0, Q_0)\) also represents an allocatively efficient outcome.
- In this case, both consumers and producers are as collectively well off as possible:
  - Consumers are maximizing utility
  - Producers are maximizing profit
  - No one can be made better off without making someone else worse off
Markets and Allocative Efficiency
- How are consumers better off?
- At equilibrium, all goods are exchanged at the price $P_0$.
  - For all quantities of goods consumed at less than $Q_0$, the marginal social benefit exceeds $P_0$ -- consumers benefit more than it costs them to consume up to $Q_0$
  - The difference between marginal social benefit and the equilibrium price is called **consumer surplus**.

Markets and Allocative Efficiency
- For all goods produced at less than $Q_0$, the marginal social cost of production is lower than $P_0$.
  - Producers able to obtain a fair market price for their output that exceeds their marginal cost of production
  - The difference between marginal social cost and the equilibrium price ($P_0$) is called **producer surplus**.

Markets and Allocative Efficiency
- Competitive markets are considered efficient because they maximize social welfare (consumer surplus + producer surplus)

Market Conditions for Perfect Competition
- All firms and consumers must be price takers ($P=MR$)
- Consumers and firms must have perfect information.
- All firms produce an identical product.
- Firms can freely enter and exit the market.
Market Imperfections
- Large majority of markets are not perfectly competitive
- Lack of perfect competition in markets results in social welfare losses
  - Reduced consumer surplus
  - Reduced producer surplus
- Types of market imperfections
  - Imperfect consumer information
  - Monopolies
  - Externalities
- Government intervenes to restore efficiency and/or equity.
  - “Public interest theory.”

Types of Government Intervention -- Public Interest Theory
- Provide public goods. (Public defense, education, roads)
- Correct for externalities (Tax cigarettes, pollution, subsidize medical research, immunizations)
- Impose regulations. (FDA)
- Enforce antitrust laws. (Review HSO mergers)
- Redistribute wealth (Medicare and Medicaid)
- Operate public enterprises. (VA hospitals)

Public Goods
- More than 1 individual simultaneously receives benefits from the good
  - i.e., no rivalry in consumption.
- Costly to exclude non-payers from consumption of the good (non-exclusivity)
- Why won’t the private market produce a socially optimal amount (MSB=MSC) of public goods?

Public Goods
- Market price of public goods approaches zero -- why?
  - Inability to exclude those unwilling to pay for benefits of public goods leads to free rider phenomenon (demand approaches infinity)
  - At market price of “zero”, private producers have no incentive to produce such goods
- Public goods examples -- defense, education, some biomedical research
- What about medical care?

Externalities
- A non-priced byproduct of production or consumption that beneficially or adversely affects others not directly involved in the market transaction.
- Externalities not possible with consumption / production of purely private goods (e.g., dental services)
- “Quasi-private” or public goods most likely to generate externalities (missing markets, lack of property rights)

Externalities
- Examples of market externalities
  - Second hand smoke
  - Air / water pollution
  - Immunizations
  - Biomedical research
- All of these market outcomes affect persons other than those engaged in these activities, and such effects are not accounted for via a functioning price mechanism
Types of Market Externalities

- Demand-side externalities -- external costs or benefits generated as a result of some consumption activity
  - Marginal Social Benefit ≠ Marginal Private Benefit as a result
  - Examples:
    - External consumption benefit -- immunizations (MSB > MPB)
    - External consumption cost -- second hand smoke (MSB < MPB)

- Supply-side externalities -- external costs or benefits generated as a result of some production activity
  - Marginal Social Cost ≠ Marginal Private Cost as a result
  - Examples:
    - External production benefit -- biomedical research (MSC < MPC)
    - External production cost -- air pollution (MSC > MPC)

Why do socially significant market externalities require governmental intervention under PI theory?

- Externalities lead to allocative inefficiency
  - Too much production or consumption relative to socially optimal amount where external costs not accounted for (2nd-hand smoke, pollution)
  - Too little production or consumption relative to socially optimal amount where external benefits not accounted for (biomedical research, immunizations)

At $Q_0^c$, $MSC_0^c > MSB_0^c$ → Cigarettes are being over-consumed.

Governmental Response to Correct Market Externalities

- Government needs to "internalize" the external costs or benefits on those parties that are generating them
- Policy approaches to correct market externalities
  - Taxes (general, user) -- reduce consumption / production activity
  - Subsidies (demand, supply) -- increase consumption / production activity
  - Market regulation (external costs)

e.g. External costs associated with second hand smoke (MPB < MSB)
- Charge a consumer tax on cigarettes that reduces consumption to the socially optimal level $Q_1$.
- Levy a producer tax on cigarette makers equal to vertical distance between MPB and MSB at $Q_1$.
- Result -- external costs of smoking fully "paid for" by smokers leading to socially optimal outcome (MSC = MSB)
Regulations

- Government can attempt to control price, quantity, or quality of health care products.
- Goal of various forms of regulatory policy is to change market outcomes and/or behaviors to be in conformance with social objectives.

Regulation of Imperfect Markets

- Types of regulation
  - Market entry (CON, patent regulations)
  - Rate/reimbursement (DRG’s)
  - Quality (FDA, PRO’s)
  - Market conduct (anti-trust)
  - Social (OSHA, EPA)

Example - Regulation of monopoly (anti-competitive) behavior

- Why is there a justification under PI theory for the regulation of monopolies?
- Monopolies are allocatively inefficient if left alone --> consumers get fewer choices and pay higher prices compared to more competitive market arrangement
- How to regulate?
  - Anti-trust regulation
  - Rate regulation

What about Social Equity?

- Are the distributive outcomes of market transactions “fair”?
- Achilles’ Heel of Perfect Competition
- All competitive markets will have winners and losers
  - Winners consume majority of resources (output, profits)
  -Losers don’t (no profits, no output)
- Affected by distribution of production inputs

Governmental intervention is justified under PI theory to redistribute resources to make competitive market outcomes more “fair” or “equitable”
Allocative Policy Options

- The government taxes one group and uses the revenues to subsidize another to improve social equity.
- Interdependent utility functions.  
  - Taxpayers receive utility from increasing the welfare of “poor” recipients (consumption externality)
- Why is the government involved?  
  - “Free rider” problem

Philosophies of Social Equity

- Vertical equity
  - "Unequals should be treated unequally."
  - People who earn more should pay higher taxes.
- Horizontal equity
  - "Equals should be treated equally."
  - Two persons with the same income level should pay the same in net taxes.

Vertical equity in practice

- How much more in taxes should higher income people pay?

- Suppose high income households pay $4,000 in taxes on average, and low income households pay $2,000. Is this equitable?

- If the high income household makes $100,000, they pay a 4% tax.
- If the low income household makes $10,000, they pay a 20% tax.
  
  *The notion of equity in taxation depends not just on total tax revenues, but on income levels and tax rates as well.*

Other forms of redistribution

- Proportional.
  - The fraction of income going to taxes is constant as income rises.
  - Medicare and Social Security taxes are a fixed % of payroll income.
- Regressive.
  - The fraction of income going to taxes falls as income rises.
  - Sales tax

- In practice, vertical equity is achieved when the net tax system is sufficiently progressive.
  - Taxes as a fraction of income rise with income.
  - Federal income tax system.
Special Interest (Economic) Theory

- The amount and types of government intervention are determined by supply and demand for legislation.
- Vote-maximizing politicians “supply” legislation.
- Wealth maximizing special interest groups demand legislation.
- Successful politicians stay in office by satisfying special interest groups.

Examples of SI theory legislative outcomes:

- Extended patent protection for brand name drugs.
- Rejection of national health insurance in favor of private insurance companies.

Special Interest (Economic) Theory

- Special interest group theory suggest that special interest groups gain at the expense of the public good
- Why?
  - Consumers are diverse, fragmented, and it is more costly for them to organize
  - Special interest groups are more powerful, have more resources, and are more effective messengers

Predicted legislative outcome(s)

- Market inefficiencies -- less competition, less information, more externalities
- Inequitable resource allocation -- unfair distribution of resources that violates one or more principles of social equity