Given the timeliness, it behooves us to explore the economics of healthcare policy

We will defer most of this discussion until the last week of class, by which time we will have covered a range of important economic issues

But this is a good time to take an historical perspective

- Chart the fate of various NHI proposals
- Examine the evolution of healthcare insurance in the U.S.
- Set the stage for our in-depth exploration of insurance markets beginning next week

*Health Insurance – the Missing Market*

Health insurance is often blamed for most of the inefficiencies in our system

- Individuals do not face the financial consequences of their decisions
- We will discuss this problem of “moral hazard” at length
- Payers all around the world, in both the public and private sector, have embraced a wide array of policies to address moral hazard
  - Centralized capital budgeting to restrict supply
  - Mandatory cost sharing
  - Oversight of physician decision making
  - Rationing access

Let’s put the horse in front of the cart

- Before any other regulatory oversight, the first goal of public policy was to provide insurance
Healthcare at the turn of the 20th century

- The healthcare system was slowly evolving
- Physicians were able to fix broken bones and prescribe drugs (while crossing their fingers), but had a few other tools in their medical kit
- Institutional care was largely to isolate those with infectious disease or otherwise remove individuals from society
- So called “poor farms” provided palliative care for those who could not afford to be nursed at home
- Health care was not expensive
  . Per capita spending in U.S. was $5 (about $100 in current $$)
  . There was considerable variation, however

Healthcare was an insurable product

- Risk-averse individuals prefer sure things to actuarially equivalent gambles (we will see this more formally next week)
- Unpredictable healthcare needs created a financial gamble

Insurance was virtually nonexistent

- Property casualty insurers did not offer health insurance
  . Q: Why do you suppose they did not offer this product?
- Employers in high risk industries paid for industrial medicine
  . To speed return to work
  . To recruit workers?
  . Industrial medicine was often provided through prepaid lodge practices – a group of physicians accepting prepayment in exchange for providing all necessary medical services
- Germany was only country to nationalize insurance coverage

- Many U.S. states instituted worker compensation programs

. Processing of payments to MDs proved to be problematic

In 1915, organized labor and the AMA backed a nationalized health insurance system

- MDs opposed the proposal

- The fact that Germany was the only nation with a nationalized system was not a ringing endorsement (Germany was blamed for starting the “Great War”)

Ongoing trends in early 1900s were revolutionizing healthcare

- X-rays and antiseptics increased the efficacy of surgery

- These began to drive up costs

- The Flexner Report of 1910 strengthened medical education requirements

  . Drove up the cost of becoming an MD
  . Restricted entry

  . MD fees increased

In 1928, President Hoover assembled the Committee on the Costs of Medical Care to perform “health services research” and report their findings

Much of the resulting report, *Medical Care for the American People*, rings true today

The most important findings pertain to the need for insurance (Table taken from the book):
The CCMC raised a number of other issues and offered several strong recommendations.
Franklin Roosevelt succeeded Hoover in 1932 and immediately faced the Great Depression

- He proposed a broad social safety net

- Desperate to win Congressional approval for Social Security and welfare, he backed off from supporting NHI (fearful that organized medicine would oppose)

Features of the 1935 Social Security Act are telling

- Social Security for all seniors
  
  . An income security program – another form of insurance
  . No means testing; all seniors are deserving of security
  . De facto inter-generation transfer from working young to retired elderly

- Welfare for low income individuals
  
  . Generosity of program left up to the states, subject to federal minimum guidelines
  . Means testing
  . Programs reflect charitable intentions of local populations

- We will see these themes recur in 1965

During the intervening three decades, there are a few aborted efforts to create some sort of national health insurance. During this time, several European nations implement NHI. Canada is still on the sidelines.

However, there were notable policy initiatives.

- Old Age Assistance vendor programs defrayed some medical costs for the elderly. These were highly variable across the states

- Hill-Burton pumped $$$millions into construction of nonprofit hospitals, which were obligated to provide charity care in exchange
One policy initiative continues to attract more attention today than any other: the preferential tax treatment of employer sponsored health insurance

- Established during Second World War to help employers attract laborers during a time of wage controls

- The $$ used to purchase health insurance on behalf of workers is not subject to income taxation

- This effectively reduces the price of health insurance relative to other goods and services purchased with after tax $$.

This is not the only reason why health insurance is employer based

- Employers create a natural risk pool

Q: Given the desire of insurers to sell to risk pools, what other sorts of arrangements might you expect to see? Why don’t you see them?

The Social Security Amendments of 1965 created Medicare and Medicaid

- Paralleling Social Security, Medicare is a national program with no means testing and the same benefits for all

  . Notable benefit exclusions included Rx and long term care

- Medicaid is administered by states subject to minimum federal standards

  . Generous federal subsidization has encouraged states to expand Medicaid
  . Enrollees must be “categorically needy”
  . Medicaid covers Rx and long term care for low income Medicare recipients
The growth of government-sponsored insurance complemented the growth of private sector coverage

- During 1930s, providers offered a form of health insurance
  . Blue Cross plans were organized by hospitals; Blue Shield plans by patients
  . Providing free care in exchange for up front insurance payments was a good way to assure their own cash flow
  . State laws gave the plans tax exempt status in exchange for community rating (more next time)

Q: If the providers were organizing the plans, what sort of plan features would you expect them to include?

- Commercial carriers emerge in 1940s and 50s
  . Q: How can they compete with the nonprofit Blues?

By the end of the 1960s, Americans had largely obtained the protection against financial risk so strongly recommended by the CCMC

- Medicare for the elderly and disabled
- Medicaid for the categorically needy
- Private coverage for workers at medium to large firms and their dependents
- Nonprofit hospitals and physicians offering a charity care “safety net” for everyone else

But this health insurance system had some serious flaws. The economic analyses that we perform over the next few weeks will expose the flaws, the implications for all stakeholders, and possible solutions.