Incorporating Health Economics into Principles of Microeconomics

Helen Schneider, Ph.D.

h.schneider@eco.utexas.edu

The University of Texas at Austin

Introduction

Introducing health economics in economics principles courses can show the value of economic thinking in analyzing important public policy issues (Cutler 2017). It can also show undergraduate students that economists can have different policy perspectives without being "mean-spirited nor ignorant of the relevant literature." (Cuter 2017, p. 219) This study will identify locations in Mankiw's Principles of Microeconomics textbook (9th edition) where relevant health economics concepts and debates can be introduced to illustrate the major microeconomic ideas that the text covers. Application of health economics concepts in introductory microeconomics can challenge students to apply economic theory to current policy issues and to illustrate complexity of real-life policies.

Ten Principles of Economics

Why do most people not engage in extreme dieting or exercising? While we often say there is no such thing as too much of a good thing, there is such thing as too much of good health when we consider opportunity cost. Most people diet and exercise moderately but do not dedicate most of their days to health improving activities.

Supply and Demand: How Markets Work

The Market Forces of Supply and Demand chapter introduces the concept of the law of demand. RAND health insurance study shows that even demand for medical care follows the law of demand: as out-of-pocket price of medical care increases, health care utilization falls.

Price elasticity of demand for medical care is 0.2 but more elastic for dental and preventative care and less elastic for hospital care. (Manning et al. 1987)

In his John R. Commons awards lecture N. Gregory Mankiw contemplates the future of Econ 101 courses and predicts that "health economics will need to play an increasing role in the introductory economics classroom" (Mankiw 2020, p. 15).

While absent from most textbooks of today, health policy issues are becoming increasingly important as healthcare spending in the U.S. increases and consumes greater share of GDP (Mankiw 2020, Cutler 2017).

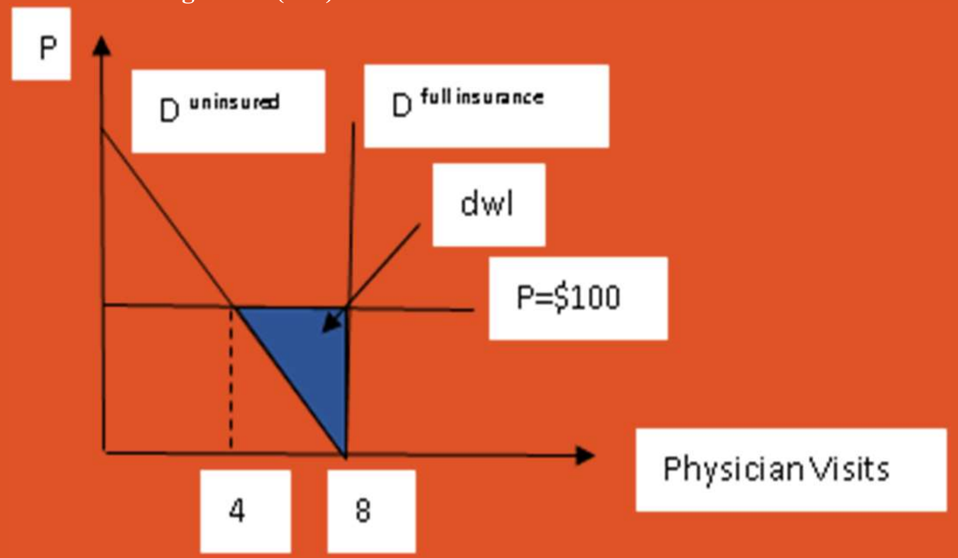
APPLICATION: Moral Hazard of Health Insurance

Greg's demand for physician visits is $V = 8 - 0.04P$, where V is the number of physician visits and P is the price per visit. Physicians will provide as many visits as demanded with a price of \$100 per visit. How many visits would Greg make when he is uninsured? What are his medical care expenditures?

Now assume that Greg can buy health insurance policy at the beginning of the year. The insurer will cover all physician visits without copayments or deductibles. How many visits would Greg make? What is the increase in health care expenditures due to insurance?

Explain moral hazard of health insurance.

Calculate deadweight loss (dwl) of moral hazard.



Economics of Public Sector

Externalities chapter is well illustrated by external costs of smoking and obesity, and external benefits of immunizations. In the age of COVID19 external costs of uninsured are especially important.

Firm Behavior and Organization of Industry

Monopoly chapter introduces the deadweight loss of imperfectly competitive markets. Note that in health care markets most of barriers to entry (e.g. licensure, patents) are created by the government.

Pharmaceutical patents are a great way to illustrate the benefits (new research) and the costs of patents (monopoly power that results in high prices on life saving drugs). Why do we pay such high prices per pill while marginal costs of production are just a few cents? Natural monopoly model with its high fixed costs of production gives students some answers.

While microeconomics courses should not use health care markets to illustrate every chapter of the microeconomics textbook, many health economics concepts can be used to add real life complexity to economic theory.

References

David M. Cutler, 2017. "Teaching Health Care in Introductory Economics." *The Journal of Economics Education* 48(3): 218-223.

N. Gregory Mankiw, 2020. "The Past and Future of Econ 101: The John R. Commons Award Lecture." *NBER Working Papers* 26702, National Bureau of Economic Research, Inc.

N. Gregory Mankiw, 2020. Principles of Microeconomics, 9th edition, Cengage.

Manning et al. "Health Insurance and the Demand for Medical Care: Evidence from a Randomized Experiment." *American Economic Review* 77:3, June 1987, 251-277.

Pauly, Mark. "The Economics of Moral Hazard," *American Economics Review* 58:3, March 1968, 531-537.