Module 3: Hospital Pricing and Competition

Part 0: Motivation

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Econ 372

History of hospitals

- Before 1900: Just don't go to the hospital! (at least in the U.S.)
  - mainly charity care
  - hospitals were a learning experience for physicians
- Early 1900s: big safety and technological improvements
- Mid 1900s: huge growth, especially in wealthy and urban areas
  - Medicare and Medicaid in 1965 (Social Security Act)

Now

As we know, we now spend **a lot** on health care in the U.S., and a big part of that is very high health care prices (and a big part of that is hospital prices)

Ownership types

1. Private not-for-profit: About 60%

2. For-profit: About 20%

3. State and local gov't: About 20%

Source: AHA Fast Facts

Non-profit hospitals

What does it mean to be a not-for-profit hospital?

From an economics perspective:

- Hospital assumed to maximize some objective function, $u(q, z)$, subject to a production constraint
- q denotes quantity of care and z denotes quality of care
- Production is constrained by the break-even condition

Non-profit hospitals

What does it mean to be a not-for-profit hospital?

From a practical perspective:

- Profits must be re-invested into the hospital
- Must show "community benefit" (no consensus definition...includes uncompensated care, services to Medicaid, and certain specialized services that are generally unprofitable)
- No taxes! and tax-free bonds

Non-profit hospitals and tax benefits

- $24.6 billion in tax exemptions in 2011
- $62.4 billion in "community benefits"
- Washington Post Article

What do you think? Are these community benefits measured appropriately?

What is a non-profit hospital?

The real question is...what is the hospital's objective function?

- For-profit in disguise
- Output maximizers
- Tax-benefit maximizers
- Social welfare maximizers

Most empirical evidence doesn't find much of a difference between FP and NFP hospitals, except FPs have higher prices. Why is that?

For-profit hospitals

These are easier to study theoretically...just a standard profit maximizing firm.

- $\pi = P(q)q - C(q)$, where q denotes quantity of care
- Firm has some market power and so faces a downward sloping demand curve