

# DEMAND FOR HEALTH CARE

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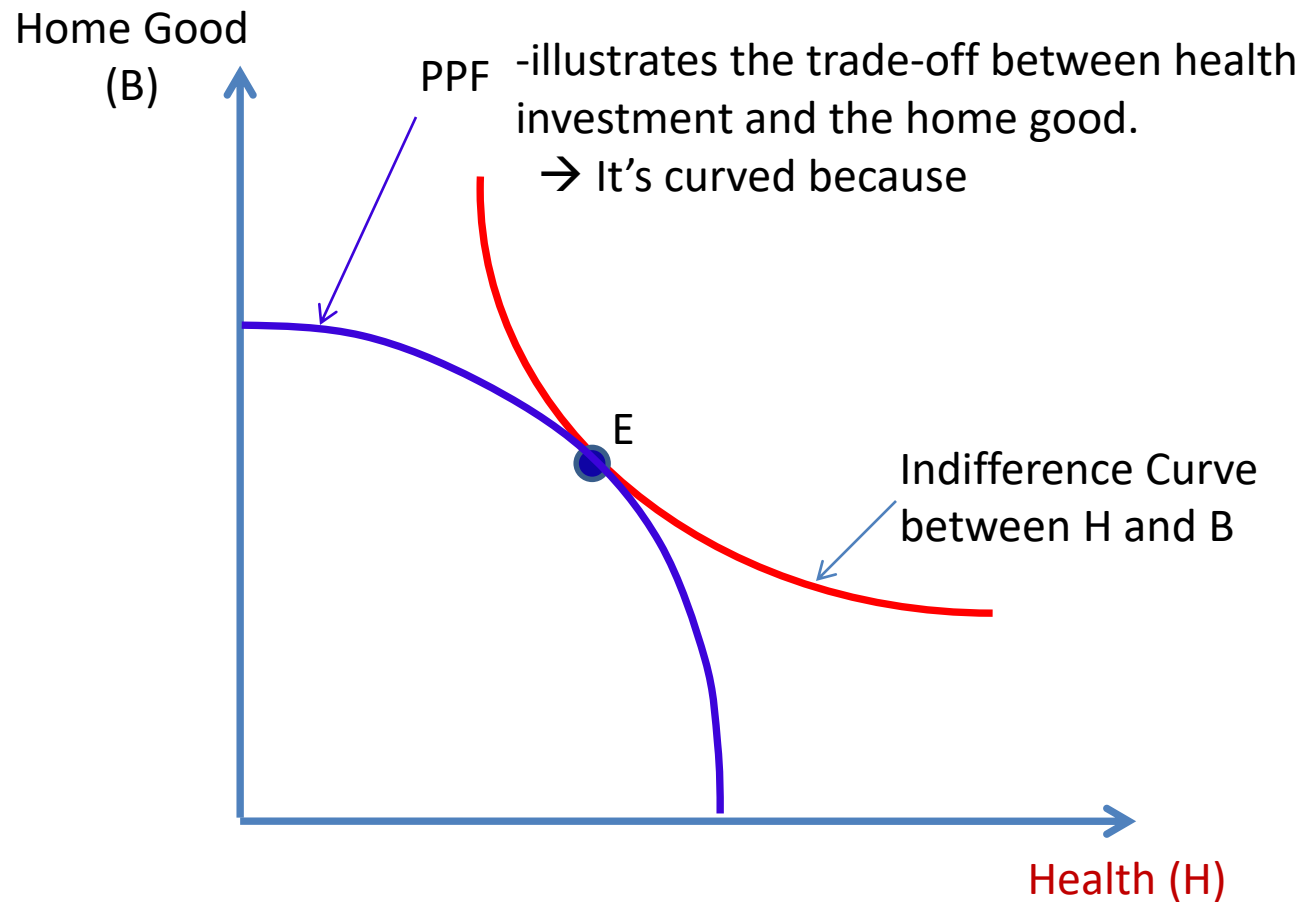
EE 474 Health Economics

Semester 2/2019

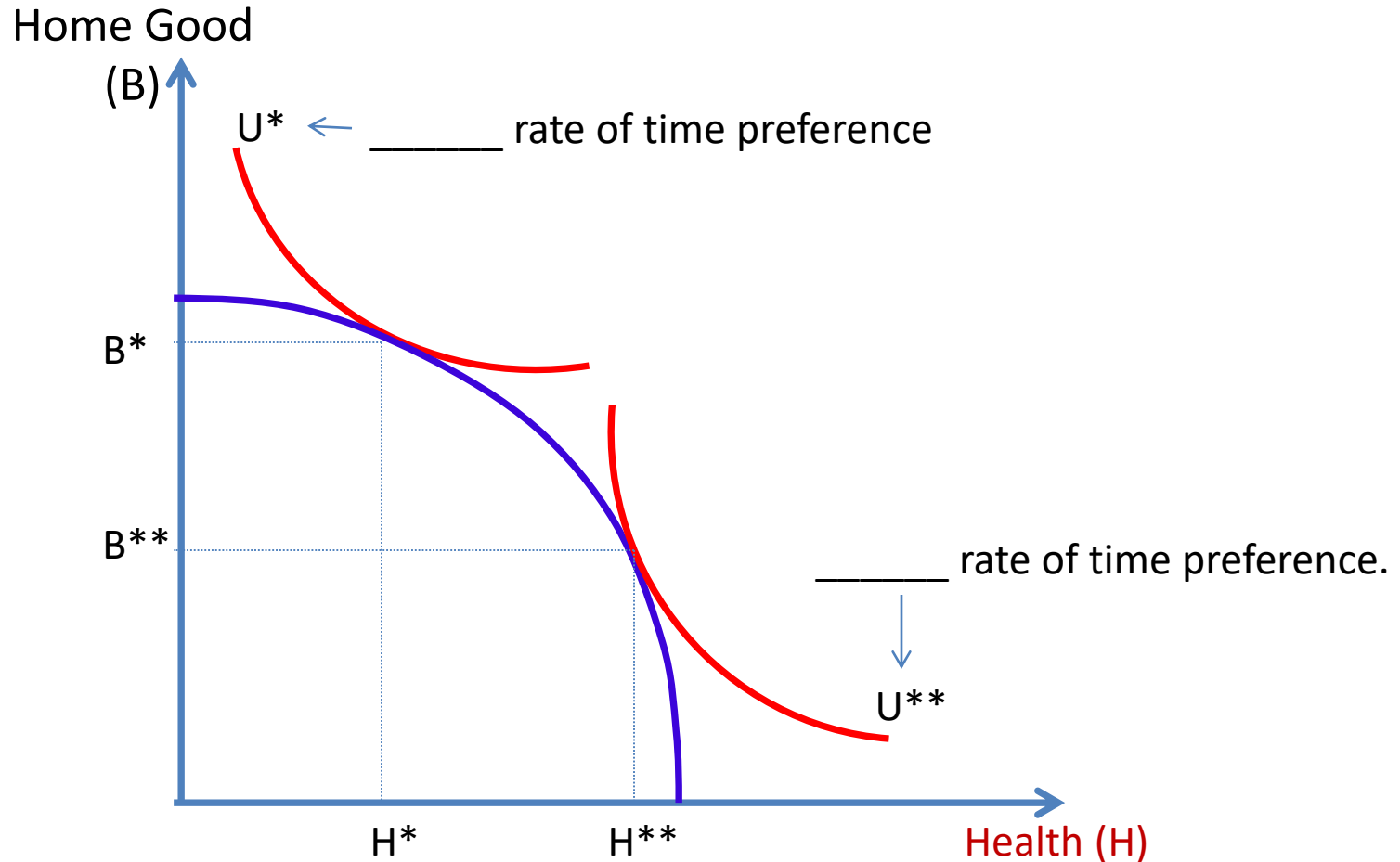
# Topics

- Demand for Health Capital (Revisited)
- Demand for Health and Health Care
- Demand for Health Care in the Standard Budget Constraint Model
- Comparative Statics
- Empirical Studies
- Other Variables Affecting Demand

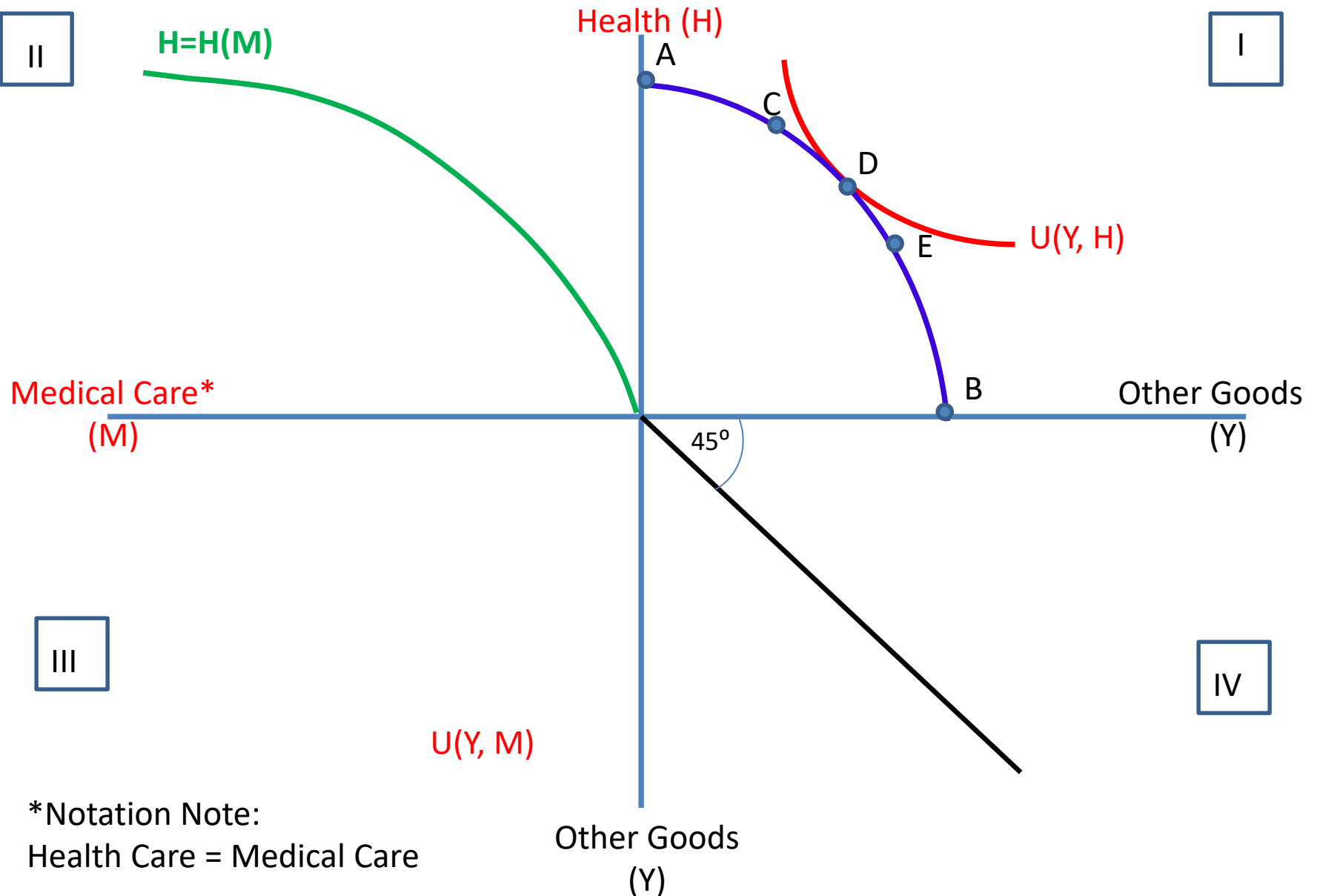
# Recall: Demand for Health Capital



# Demand for Health Capital at Different Rates of Time Preference



# Demand for Health and Health Care



# Switching from Health Capital (H) to Medical Care (M)

- Now, we want to derive *the demand for medical care*.
  - We've shown that  $H=f(M)$ , so the demand for M is derived from the demand for H.
- Consider *the utility as a function of other good (Y) and medical care (M)*, rather than health (H):  $U = U(Y, M)$
- Assume that M is homogeneous and represents the number of units of medical care.
- The *budget line is a straight line* because each unit of M costs the same number of dollars and means the same reduction in Y.
  - The slope of the budget constraint is constant.

# Consumer's Maximization Problem

- The consumer's problem now is:

Maximize  $U = U(Y, M)$

subject to  $I = P_M * M + P_Y * Y$ ,

where  $I$  = total income,

$P_M$  = Medical care price per unit

$P_Y$  = Price per unit of other goods

- Let  $P_Y = 1$ . So, the budget can be simplified to

- $I = P_M * M + Y$

➤ Or

# Standard Budget Constraint Model

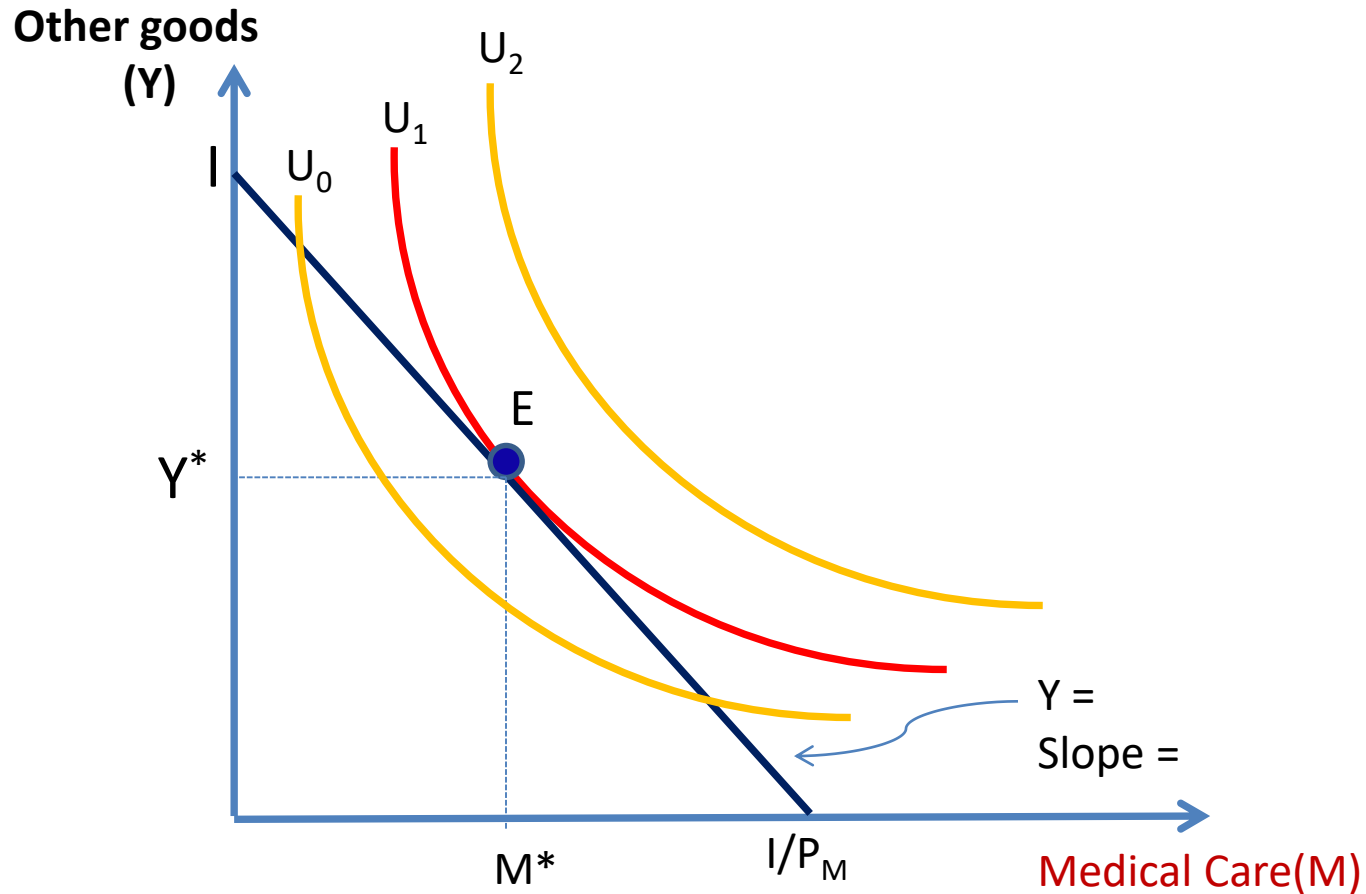
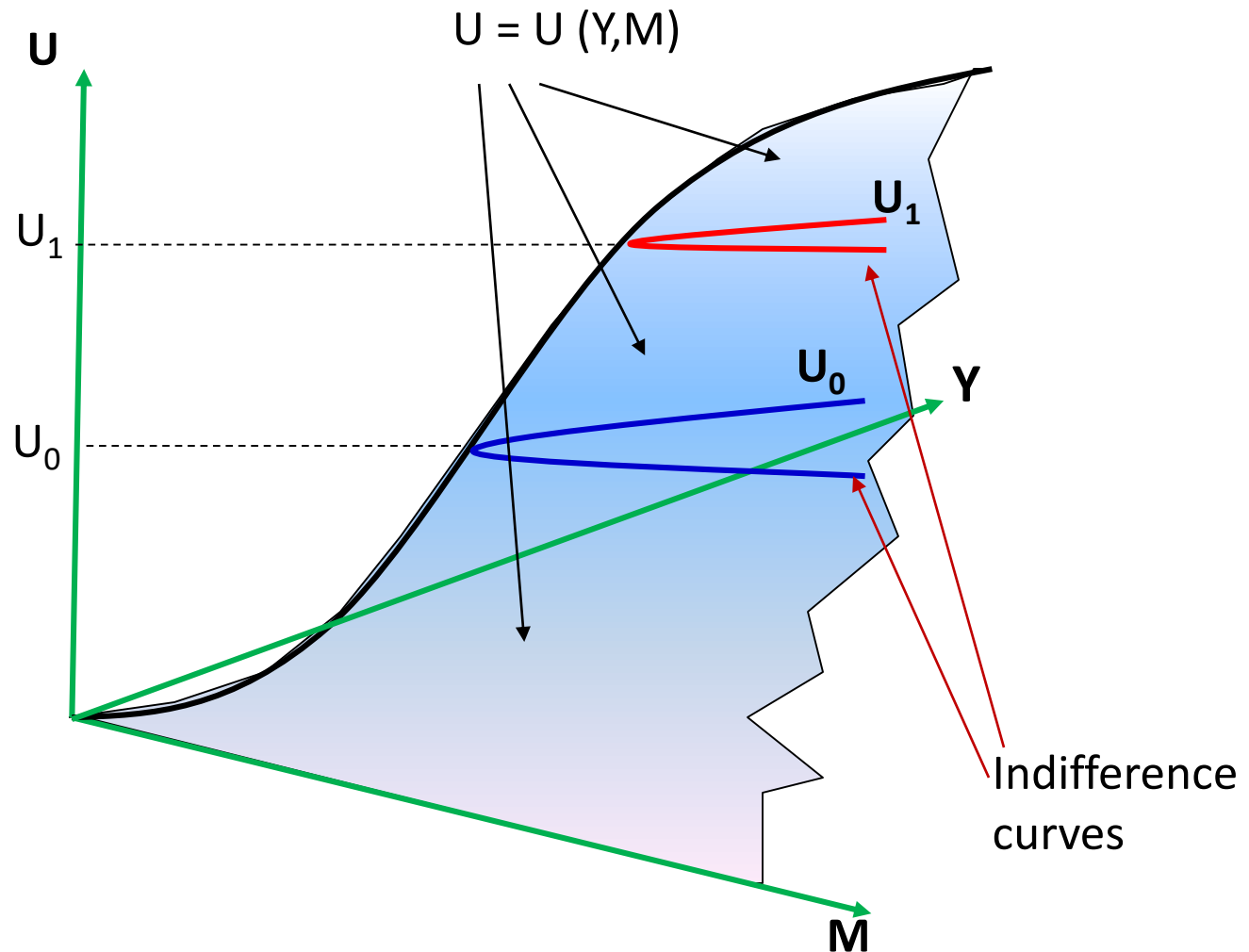
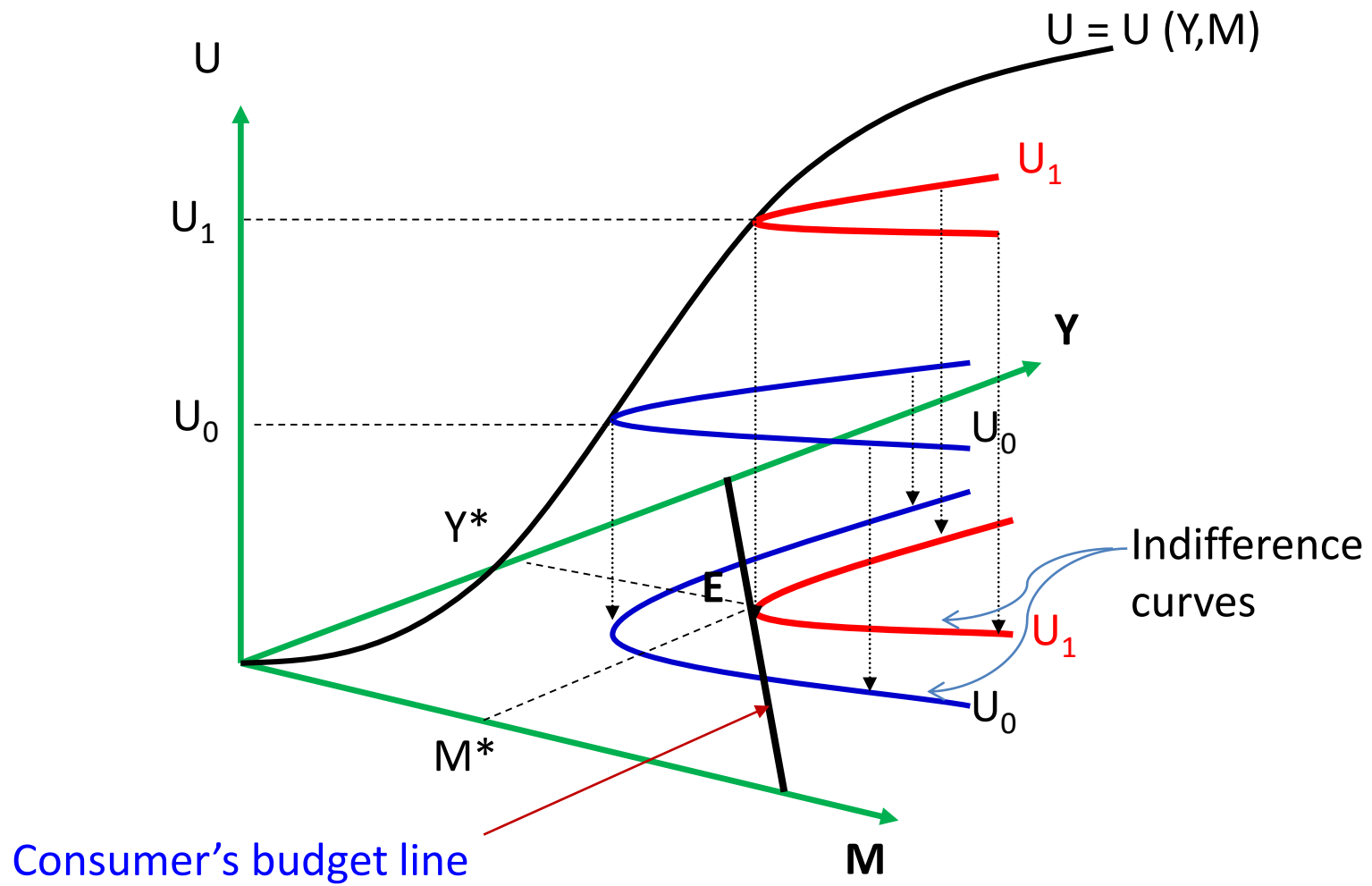


Illustration of  $U = U(Y, M)$  in a 3-space diagram.





# Utility Maximization

- At point E the slope of indifference curve  $U_1$  (marginal rate of substitution) is just equal to the price ratio:

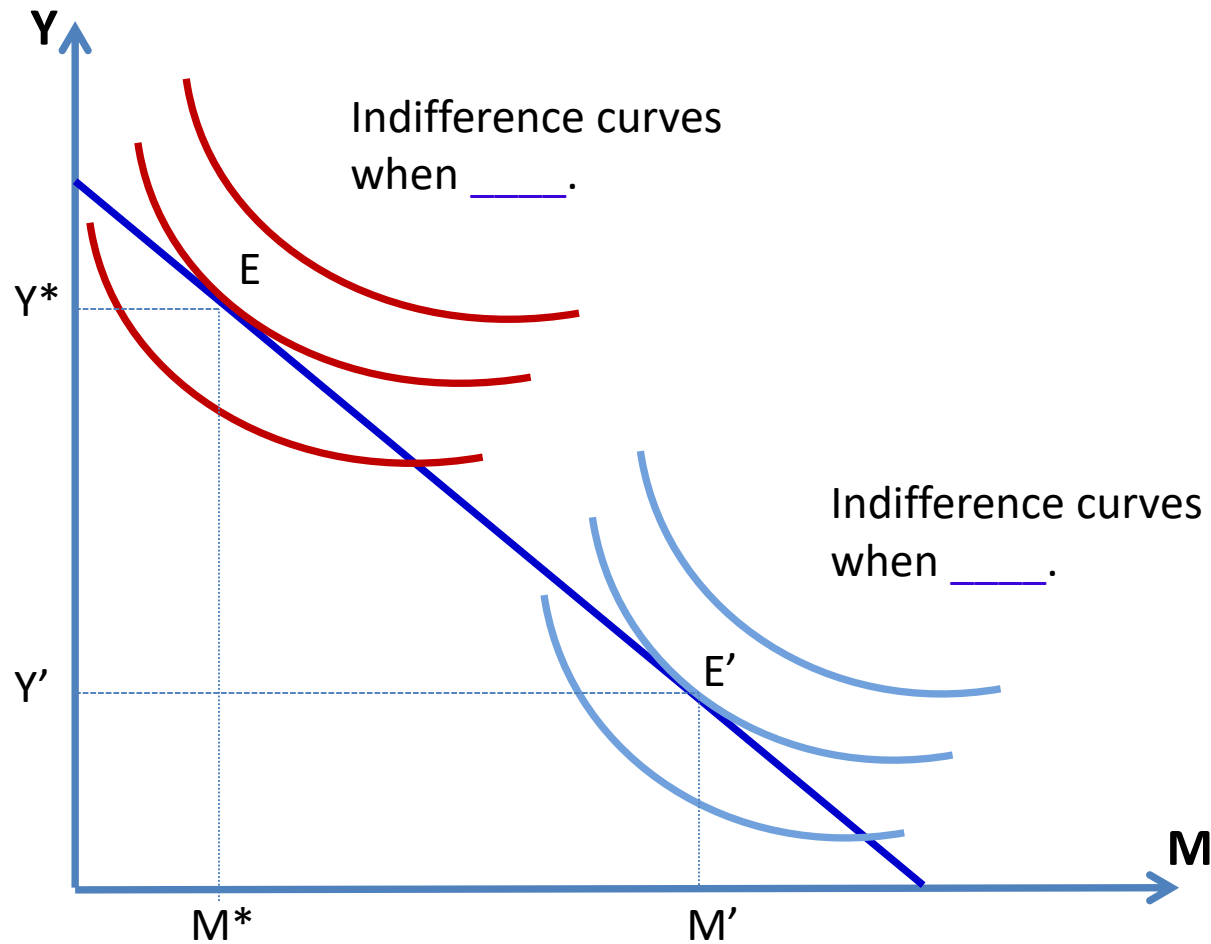
$$MRS_{MY} =$$

- The marginal rate of substitution (MRS) is a measure of the rate at which a consumer is *willing* to trade other goods for medical care.
- The price ratio is a measure of the rate at which a consumer *can* trade other goods for medical care.

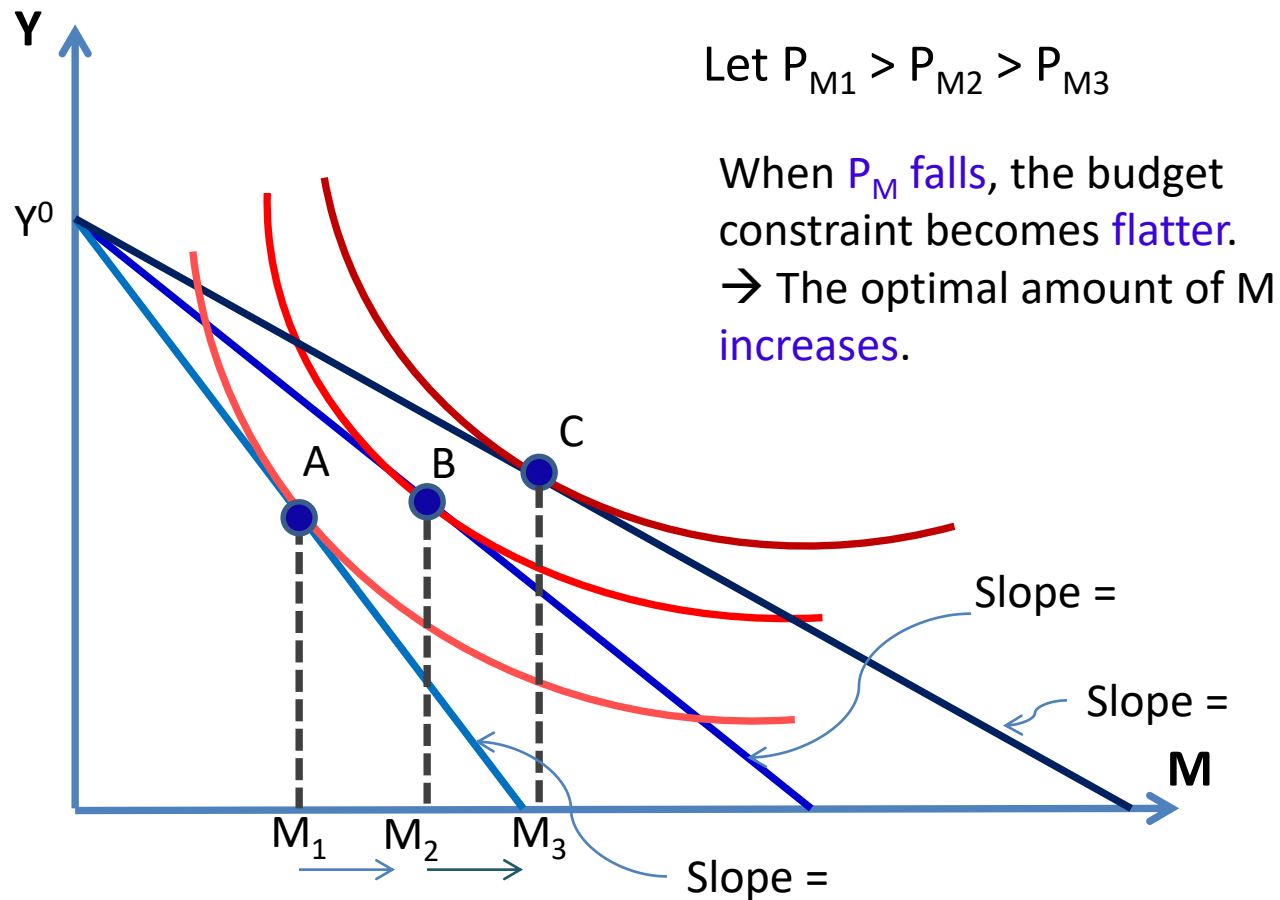
# Comparative Statics

- **Comparative statics** is a type of analysis where the original equilibrium is identified, and *after a change occurs*, the new equilibrium is compared to the old one.
- We will consider how the following changes affect the demand for medical care.
  - Change in **health status**
  - A decrease in **medical care price**
  - An increase in **income**
  - An increase in the **price of a substitute** (or **complement**)
  - Two other factors that affect demand for medical care:
    - **Time cost**
    - **Coinsurance**

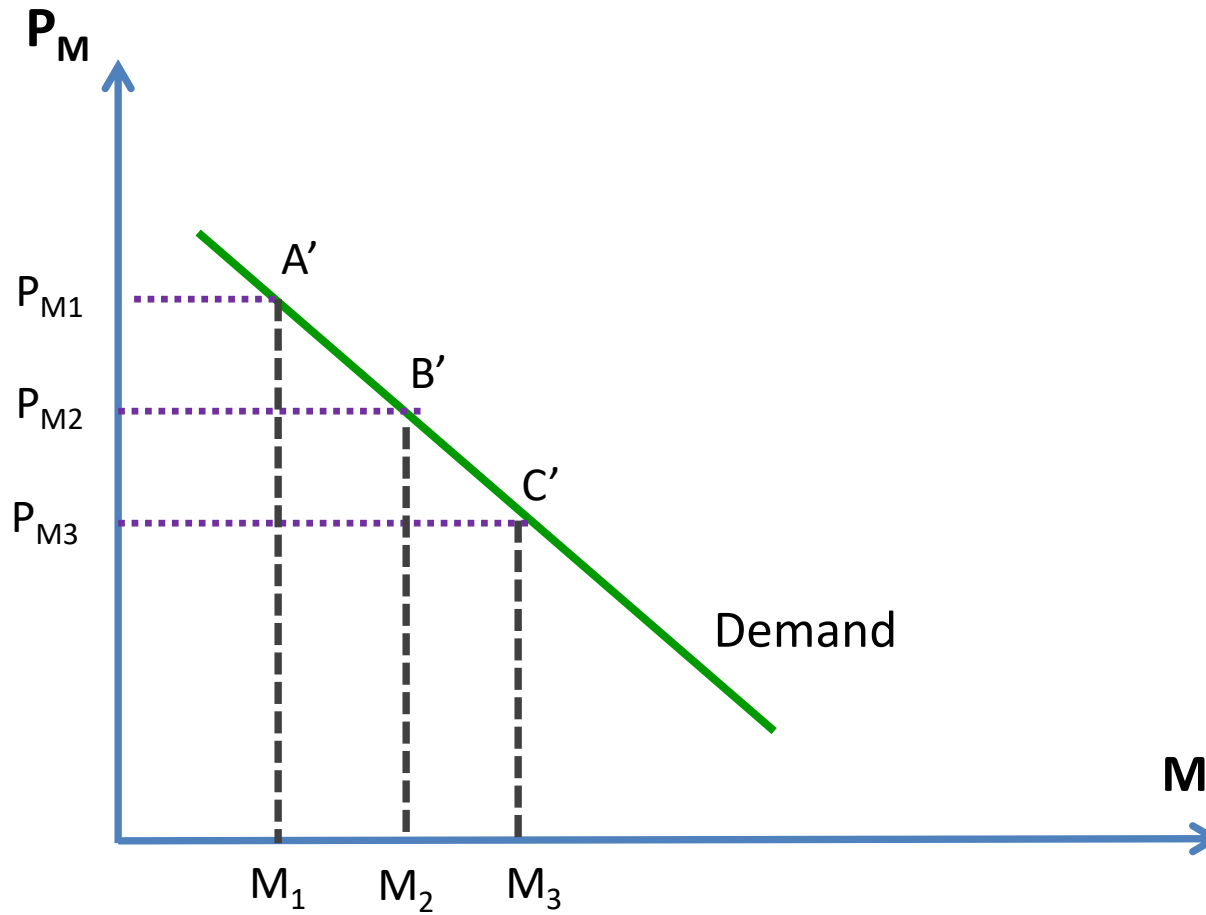
# Changed Preference due to Illness



# What Happens when $P_M$ Falls?



# The Demand for Medical Care



# Price Elasticity of Demand

- The **price elasticity of demand** measures the **responsiveness of the consumer's demand to price**.
- Price elasticity,  $E_p$ , is the ratio of the percentage change in quantity demanded to the percentage change in price.

$$E_p = \frac{(\Delta Q_d / Q_d)}{(\Delta P / P)} = \frac{\Delta Q_d}{\Delta P} \frac{P}{Q_d}$$

- Example: Suppose at  $P_1 = 25$ ,  $Q_1 = 6$ , and at  $P_2 = 30$ ,  $Q_2 = 5$ . What is the price elasticity of demand at the average price?

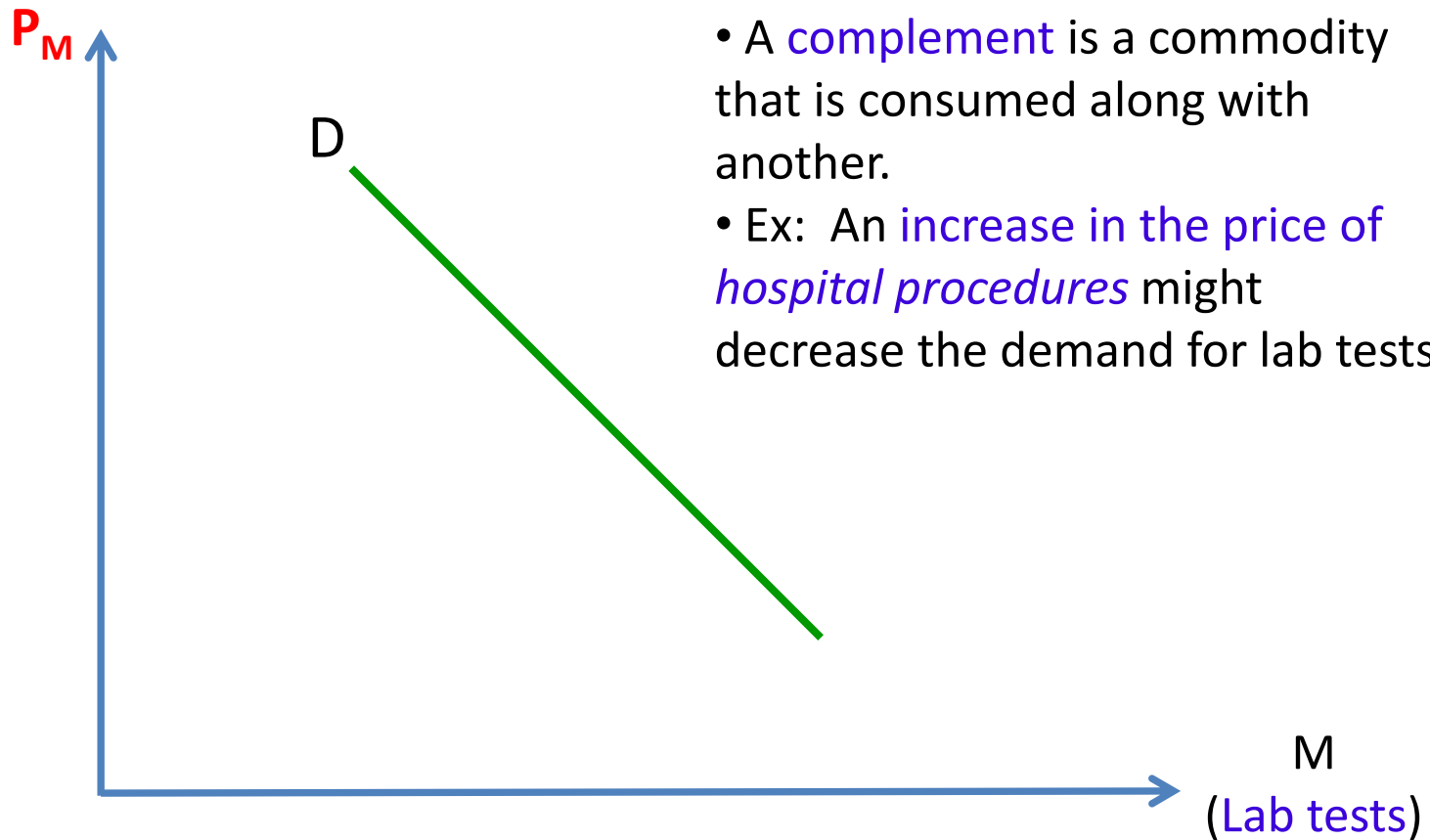


# Income Elasticity

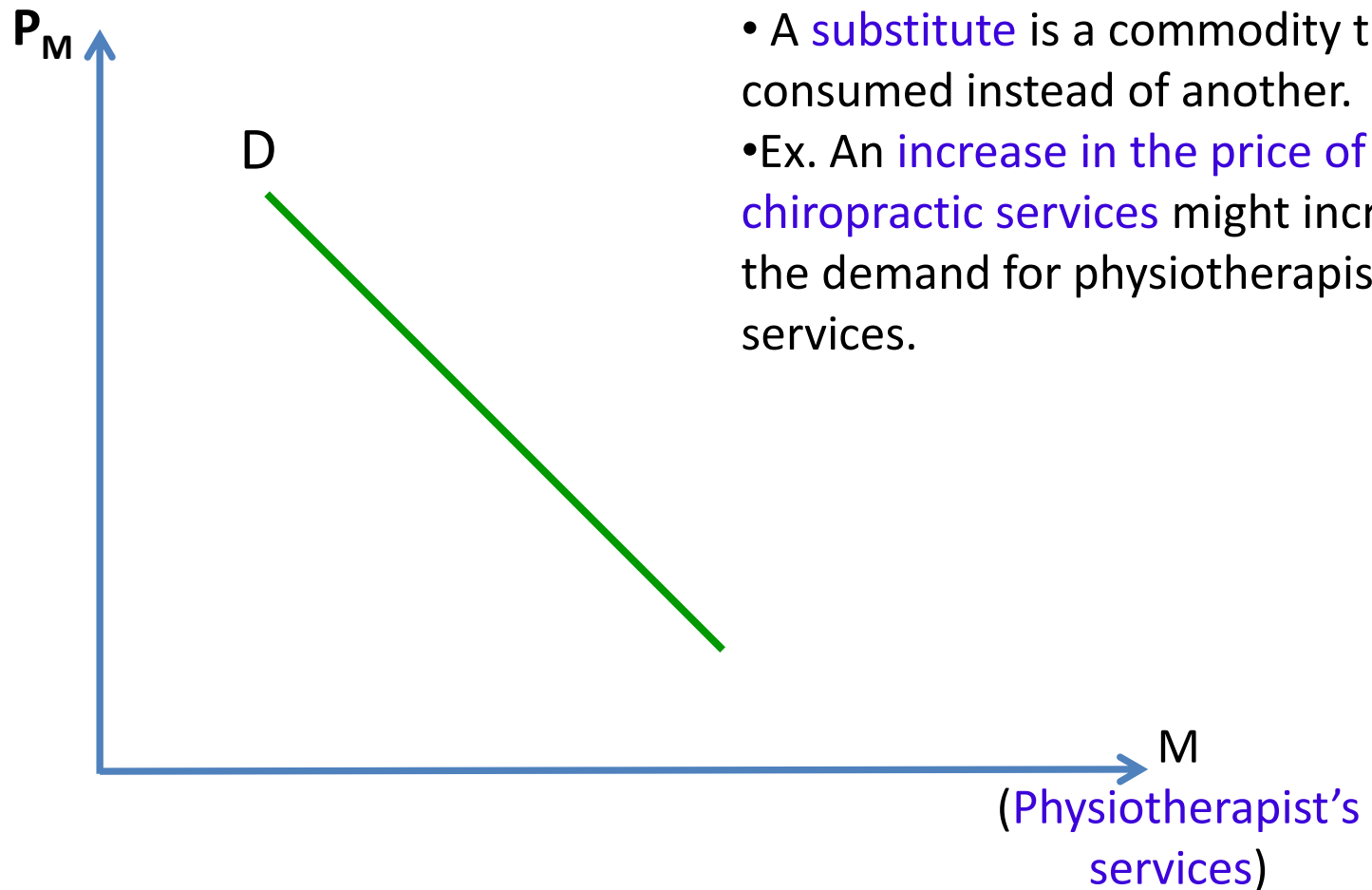
- The income elasticity of demand measures the **responsiveness of demand to changes in income**.
- Income elasticity,  $E_I$ , is the percentage change in quantity demanded divided by the percentage change in income:

$$E_I = \frac{(\Delta Q / Q)}{(\Delta I / I)} = \frac{\Delta Q}{\Delta I} \frac{I}{Q}$$

# What Happens if the Price of a Complement Increases?



# What Happens if the Price of a Substitute Increases?



- A **substitute** is a commodity that is consumed instead of another.
- Ex. An **increase in the price of chiropractic services** might increase the demand for physiotherapist's services.

# Role of Time

- Suppose the medical care is physician visits.
- The **total cost** of a physician visit might include both the **money price of the visit** itself and the **cost of being away from work and not getting paid**:

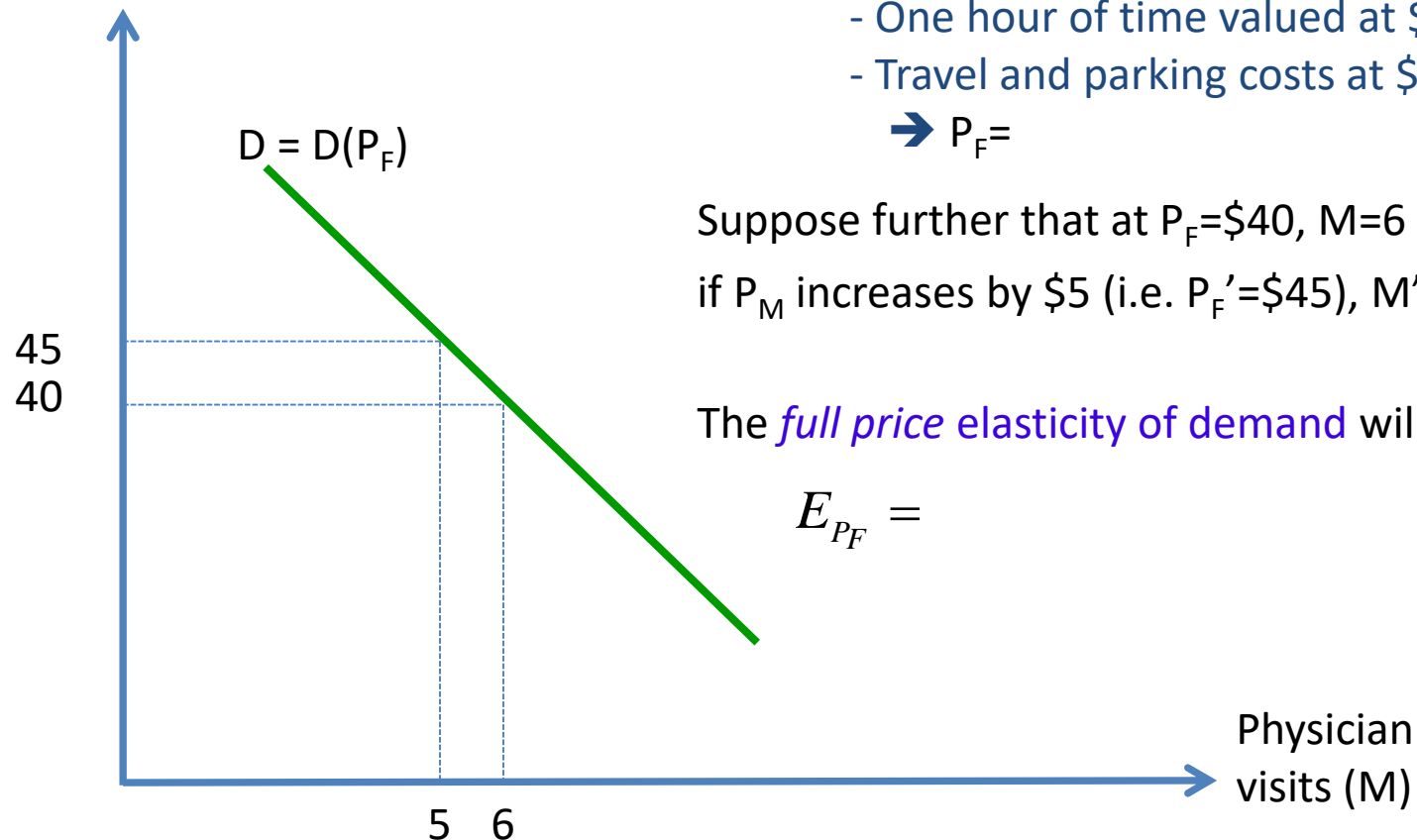
$$\text{➤ } P_F = P_M + P_T = P_M + wT,$$

Where  $P_F$  = Full price,  $P_M$  = Money price,  $P_T$  = Time price,  $w$  = wage rate, and  $T$  is time spent in obtaining care.

- So, the **longer the time (T)** involved in traveling, waiting, and receiving services, the **higher the total price of medical care, and the smaller the quantity demanded**.
- Similarly for higher wages ( $w$ )

# Example: Demand and Time Price for Physician Visits

Full Price ( $P_F$ )



Given: - One visit priced at \$25  
 - One hour of time valued at \$10  
 - Travel and parking costs at \$5  
 $\rightarrow P_F =$

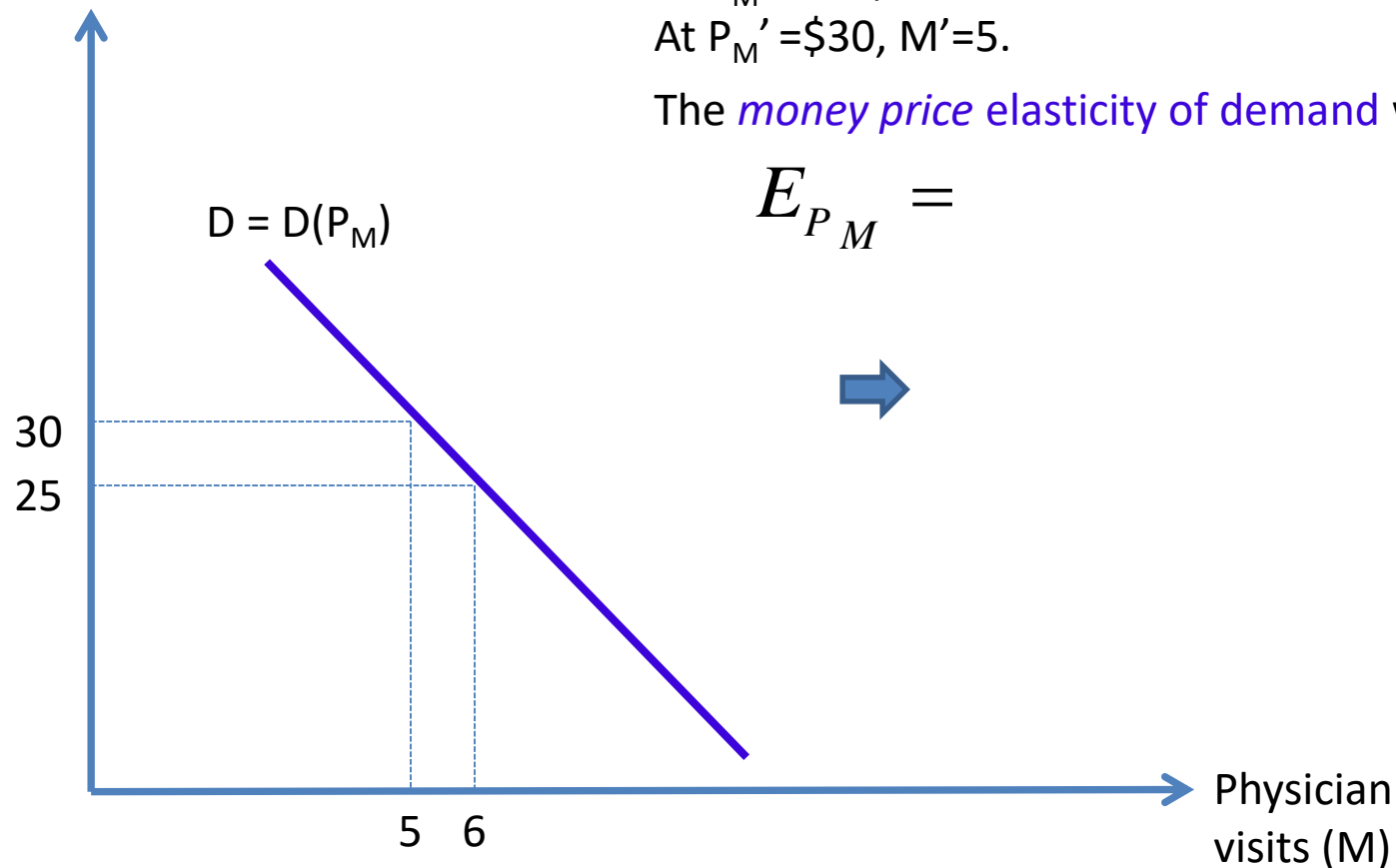
Suppose further that at  $P_F = \$40$ ,  $M = 6$  and if  $P_M$  increases by \$5 (i.e.  $P_F' = \$45$ ),  $M' = 5$ .

The *full price elasticity of demand* will be:

$$E_{P_F} =$$

# Example: Demand and Time Price for Physician Visits (cont'd)

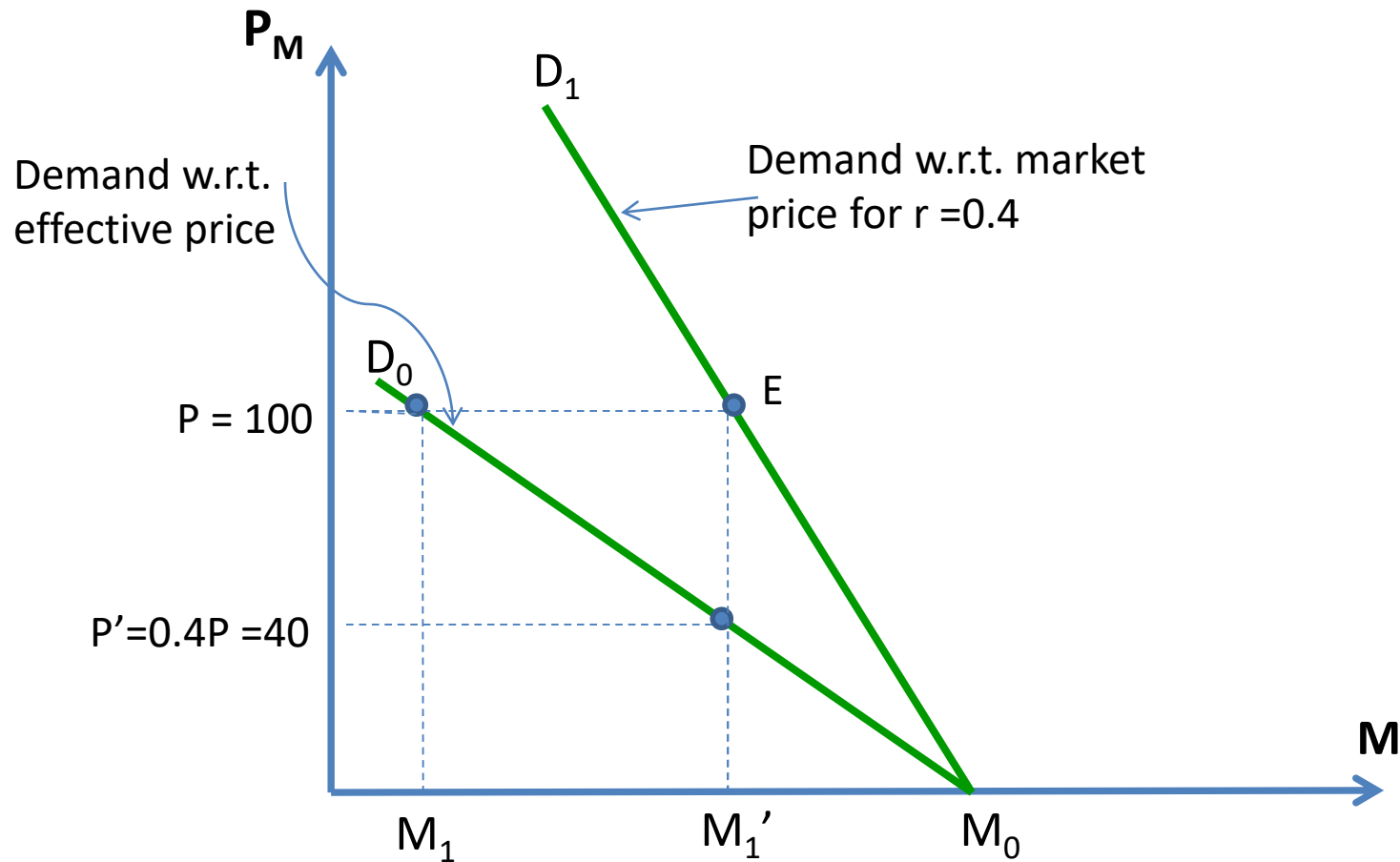
Money Price ( $P_M$ )



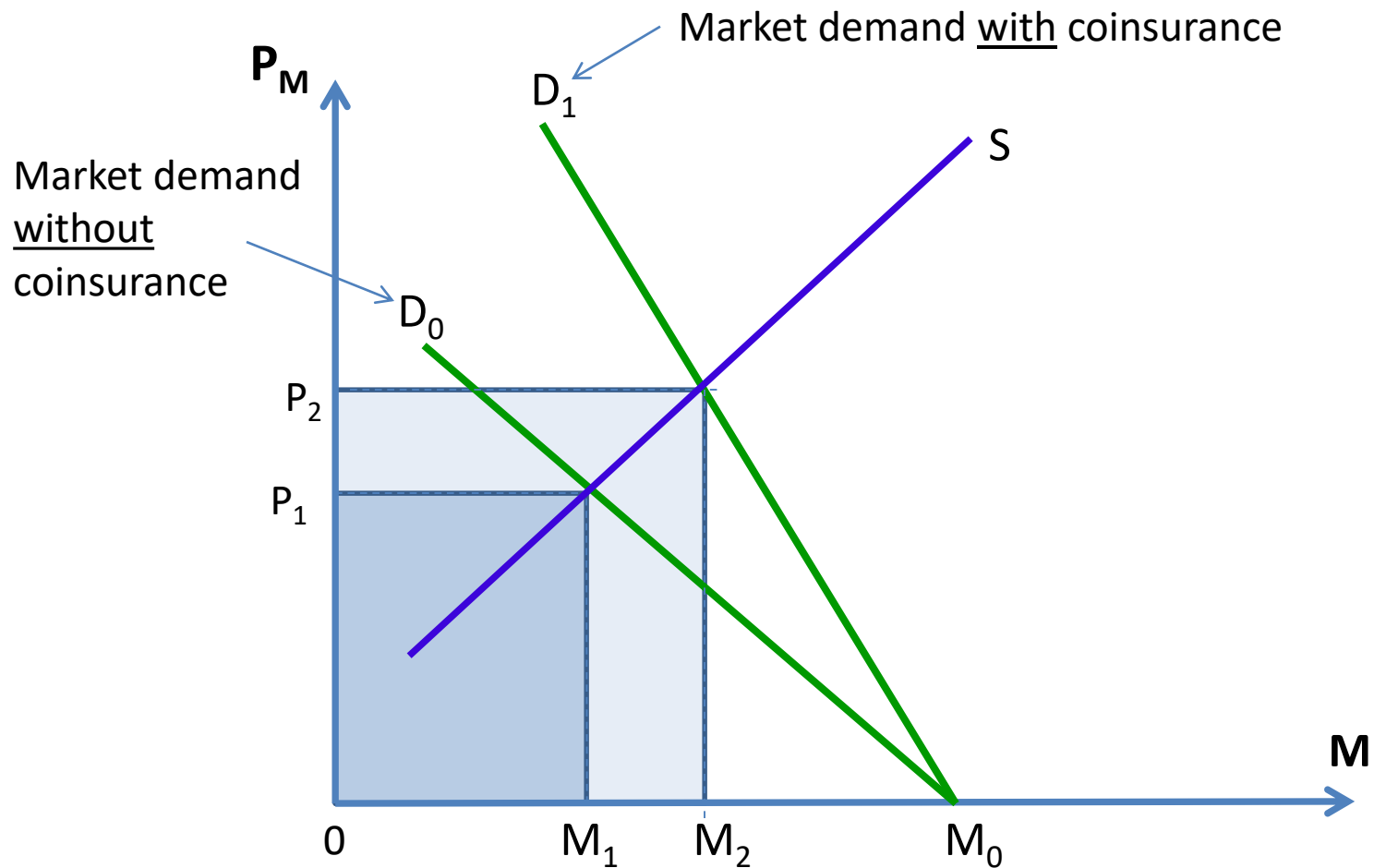
# Applications: Time Costs

- People with **lower opportunity costs of time** would be **more likely tolerate or endure long waiting times** in clinics or physician offices.
- Even for the poor whose medical care is subsidized, they still have to pay for the time costs.
  - Examples:
    - Medicaid in the US,
    - UC Scheme in Thailand (long waiting time)
  - Solutions:
    - Build health facilities near people's residence
    - ???

# Role of a Coinsurance Rate



# Market Effects



# Empirical Studies

- Demand function for physician visits ( $V$ ) can be written as:

$$V = f(P, r, t, P_0, Y, HS, AGE, ED, \dots)$$

where  $P$  = price per visit,

$r$  = patient's coinsurance rate,

$t$  = time price,

$P_0$  = price of other goods,

$Y$  = income,

$HS$  = the patient's health status,

$AGE$  = age,  $ED$  = education

- 'Usual' econometric specification for the above demand function:

$$V = b_0 + b_1P + b_2r + b_3t + b_4P_0 + b_5Y + b_6HS + b_7AGE + b_8ED + \varepsilon$$

or  $\ln V = b_0 + b_1 \ln P + b_2r + b_3t + b_4P_0 + b_5Y + b_6HS + b_7AGE + b_8ED + \varepsilon$

➔  $b_1 =$

# Issues in Empirical Studies on the Demand for Medical Care

- Measurement
  - Measure “medical care/services” in monetary values
    - One problem is that expenditures reflect a complex combination of price of care, quantities of care, and qualities of care
  - Alternative measures : *quantity of visits, patient days, or cases treated*
    - Still have problems with the intensity of care.
- Definition of the price of services
  - Many patients do not pay the full price for their treatments.
- Differences in study populations

# Example: Price Elasticities

Study	Dependent Variable	Price Elasticity
All Expenditures: Manning et al. (1987)	All expenditures	-0.17 to -0.22
Physician Services:		
Newhouse and Phelps (1976)	Physician office visits	-0.08
Cromwell and Mitchell (1986)	Surgical services	-0.14 to -0.18
Wedig (1988)		
Health perceived excellent/good	Physician visits	-0.35
Health perceived fair/poor	Physician visits	-0.16
Hospital Services:		
Newhouse and Phelps (1976)	Hospital length of stay	-0.06
Manning et al. (1987)	Hospital admissions	-0.14 to -0.17
Nursing Homes:		
Chiswick (1976)	Nursing home residents per elderly population	-0.69 to -2.40
Lamberton et al. (1986)	Nursing home patient days per capita elderly	-0.69 to -0.76

Source: Table 9.2 in Folland et al. (2013)

# Example: Income Elasticities

Study	Dependent Variable	Income Elasticity
All Expenditures:		
Rosett and Huang (1973)	Expenditures	0.25 to 0.45
Hospital Services:		
Newhouse and Phelps (1976)	Admissions	0.02 to 0.04
Physician Services:		
Newhouse and Phelps (1976)	Visits	0.01 to 0.04
Nursing Homes:		
Chiswick (1976)	Residents per elderly population	0.60 to 0.90

Source: Table 9.4 in Folland et al. (2013)

# Other Factors Affecting Demand for Medical Care

- **Ethnicity and Gender**
  - In general, 'blacks' tend to consume less medical care.
  - Females, particularly at child-bearing ages, are heavy users of health care. Also, females generally live longer, so they are predominant among elder patients.
- **Urban vs. Rural**
  - People living in rural areas use less care. (Access problem? Or, socioeconomic status?)
- **Education**
  - Educated people are more informed and may demand more health care.
  - Often, education is correlated with income, and income actually leads to more demand for health care.

# Other Factors Affecting Demand for Medical Care (Cont'd)

- **Uncertainty**
  - People demand health care for precautionary purposes, e.g. preventive care.
- **Age**
  - Grossman: As we age, the depreciate rate gets larger. So, more health inputs are required to restore health.
- **Health status**
  - The sicker tend to demand more health care.