



## Economics of Healthcare

An approachable beginner's guide to health economics that brings the economist's way of viewing the world to bear on the fundamentals of the US healthcare system. The conversational writing style, with occasional doses of humor, allows students to see how applicable economic reasoning can be to unpacking some of the sector's thorniest issues, while accessible real-world examples teach the institutional details of healthcare and health insurance, as well as the economics that underpin the behavior of key players in these markets. Many chapters are enhanced by "Supplements" that offer how-to guides to tools commonly used by health economists, and economists more generally. They help form the basic "economist's toolbox" for readers with no prior training in economics, and offer deeper dives into interesting related material. A test bank and lectures slides are available online for instructors, alongside additional resources and readings for students, taken from popular media and healthcare and policy journals.

**Andrew Friedson** is Director of Health Economics for the Research Department at the Milken Institute. Prior to this he taught undergraduate and graduate health economics at the University of Colorado Denver for over a decade. He has received numerous teaching and research award nominations, and won the 2015 National Tax Association's Richard Musgrave Prize, as well as an Impact Award as part of the University of Colorado Denver's 2021 Pandemic Research and Creative Activities Awards. His research on public health insurance, cost of care provision, medical malpractice, risky health behaviors, and public health regulations has been covered in media outlets such as *The New York Times*, *The Wall Street Journal*, *Newsweek*, and *The Economist*, as well as academic publications including *Health Economics*, the *Journal of Human Resources*, and the *Journal of Health Economics*.

“This is the book health economics instructors and students have been waiting for! The real-world examples immediately draw in readers and provide a foundation for looking at important issues in health care from an economic perspective. Dr. Friedson’s approach to examining complex topics is both intuitive and hilarious.”

Professor Elizabeth Munnich, *University of Louisville*

“A captivating tour of the economic foundations of modern healthcare. With practical examples and delightful humor, this book effortlessly breaks down complex concepts, making health economics accessible to diverse readers. A must-have resource for students seeking a comprehensive grasp of healthcare markets and the challenges they entail.”

Professor Sarah Miller, *University of Michigan*

“This is a book on the economics of healthcare that is well organized, comprehensive in its coverage, and actually fun to read! It is well suited for a diverse audience, including undergraduate and graduate students from different degree programs, practitioners, and policy makers.”

Professor James H. Marton, *Georgia State University*

“The hallmark of this book is its dedication to practicality. Demanding no prerequisite economics background, Friedson’s “Health Economics” is ideal for students and professionals in public health and healthcare management. Rich with insights into the economics of the healthcare industry, it occupies a unique space in the health economics literature.”

Professor Natallia Grey, *Iowa State University*

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# Economics of Healthcare A Brief Introduction

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## Preface

It is incredibly uncommon for an individual to go through life without somehow touching the healthcare sector. In every year since 2010, the US has spent over 17 percent of its gross domestic product (GDP) on healthcare. Thus, it is no surprise that understanding the healthcare sector has become central to business, policy, and citizenship. To match the expansion of the healthcare sector there has been an expansion in course offerings for studying the economics of healthcare. This book is meant to serve as an introduction to both the healthcare sector and the economist's way of viewing the world simultaneously. If you want to get your students (or your in-laws) up to speed quickly, this is a book written to do just that: help people become competent with the core logic and concepts that drive the healthcare sector.

### *Why Economics of Healthcare: A Brief Introduction?*

There are many textbooks on health economics. My first course on the topic (which had a fantastic textbook) opened my eyes to a field of study that has held my interest and imagination for the better part of two decades. But, by the time I took that course, I was already an economics major with several years of training under my belt. The textbook I used, and many of the existing textbooks are made to slot into the usual progression of coursework for an economics major: first you learn the language of economics, then you learn the tools of an economist, and then you finally get to put it all together and apply your skills in a field course such as health economics. I think that this keeps a lot of people from learning economics, because they stop before they get to see (what for them are) the most interesting applications.

Someone interested in healthcare, for example, might be better off learning price elasticities at the same time they learn what causes individuals to go to (or not go to) see a doctor. There are potentially large benefits to students from seeing the applications up front and learning the tools that they need as they need them. That's what this book does: it teaches the economics tools as you need them to understand a specific area of study.



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There is no need for a student to have a prior background in economics, the book is a one stop shop.

## Intended Audience and Level

Given that this book teaches economics tools at the same time that it teaches the economics of the healthcare sector, it is a great fit for students in programs such as Master of Public Health (MPH), Master of Public Administration (MPA), or Master of Business Administration (MBA) where courses with titles such as “Health Economics” or “Healthcare Economics” or “Economics of the Healthcare Sector” are commonly the only economics course that the students have ever taken (or will ever take). When I taught “Healthcare Economics” for the MPH program at the Colorado School of Public Health, this was exactly the case: the course included students with medical, public health, and social work backgrounds (as well as a few with backgrounds in the social sciences, including economics) and was for many of them their first and only exposure to economics.

This book also works well for a “no prerequisites” field course in health economics offered by an economics department as part of an undergraduate degree. Recruiting into economics majors can be difficult, and we lose many students along the way who start with introductory macroeconomics or introductory microeconomics and never get to see applications such as are seen in a health economics course.

It is also important to note that along with requiring little prior knowledge of economics, this book also requires a much less rigorous base of mathematical knowledge than a typical economics textbook. That’s not to say that there is no math present, but that all math used beyond high school level concepts (and even some of the high school level concepts) are explained as they arise. Given the large differences between healthcare sectors across nations, this book focuses in on the United States specifically.

## Structure

The book is broken into four parts. The first part of the book deals with fundamentals of consumer choice theory, looked at from the point of view of the consumer of healthcare (i.e. the patient). This section covers topics such as what drives decision-making (how individuals account for benefits and costs, and the concept of optimization), production of health (a simplified version of the Grossman model), demand for medical care, demand

distortions due to insurance, and how to evaluate evidence. This lays the groundwork for much of the logic and economic intuition that will be applied in later chapters.

The second part of the book focuses on the production side of the health-care sector, covering topics such as firm behavior, the makeup of the labor force, provider responses to incentives (some of this is an application of personnel economics), and hospital structure and behavior. Also in this section of the book is the basics of markets under perfect competition, a topic which tees up the remainder of the book: the healthcare sector is full of features that cause the logic (and benefits) of perfectly competitive markets to not always apply, and the rest of the book largely explores these areas.

The third part of the book deal with health insurance, health insurers, and the consequences of having these actors in the sector. Part three begins with a chapter on health insurance as a product, and then moves on to topics such as adverse selection in the health insurance market, how prices are distorted by having insurers as intermediaries, managed care organizations, and public insurance programs.

The final part of the book deals with parts of the sector that require understanding of behavior of buyers, sellers and insurers to truly unpack. These chapters are largely self-contained, giving instructors some additional flexibility in course design based on their individual pedagogical priorities. Topics in this part of the book include pharmaceuticals, externalities, medical malpractice, inequality, and comparisons of different health-care systems.

## Features

- Health economics content that is appropriate for a novice economist, no prior economics is needed to pick up and dive in.
- Casual, conversational writing style. This book is meant to be a relatively easy read as compared to traditional “dry” texts. Topics are introduced with intuitive examples, and a dose of humor when appropriate.
- Non-technical explanations of both economic fundamentals and health economics. Mathematical proficiency is not a requirement for understanding and using the text.
- Many chapters have end of chapter supplements that provide “how-to” guides on common tools used by health economists and economists more generally. These include how to use price indices, how to calculate measures of market power, and how to do a benefit–cost analysis. The supplements are slightly more technical than the rest of

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the text but will still be simplified relative to traditional texts. They will help form the basic “economist’s toolbox” for readers with no other training in economics. Other end of chapter supplements will provide deeper dives on interesting tangential material.

- End of chapter assessment questions. These are meant to get students thinking about and applying the material.

## Online Features

- Test bank of questions that can be used for homework or exams
- Lecture slides
- Bank of related readings in popular press and accessible journal articles, as well as related podcasts.



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