Supply of health care – Hospitals 2

Angela Fertig

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- Last time, we discussed economies of scale and competition.
- Today, we discuss 2 other topics relevant to hospitals.

Cost Shifting

Are the costs of uncompensated care passed on by hospitals to other patients?

- Let's assume that hospitals are monopolies in their town – meaning that they can choose their prices.
- We need monopoly theory to understand.

Monopolies

Defn: Monopoly

1. one seller – price-setter (downward sloping D)
   Marginal Revenue
   - Competitive Firm: AR=P=MR
     When produce 1 more, I sell it for P = marginal revenue
   - Monopolist: AR=P but MR<P
     When produce 1 more, to sell it, P falls (for this unit and all Q) b/c demand curve is downward sloping
2. no close substitutes
3. usually entry is difficult (barriers)

Profit Max

- Choices are both P and Q.
- If I make and sell one more, can I make more money?
- Compare MC with MR
- Let's assume that marginal cost is constant.
- Profit Max in Monopoly is P>MR=MC (markup)

Measuring Profit

$$\begin{aligned}
\text{Profit} &= \text{TR} - \text{TC} \\
\frac{\text{Profit}}{Q} &= \text{TR/Q} - \text{TC/Q} \\
\text{Profit} &= (\text{P} - \text{ATC})\text{*Q}
\end{aligned}$$

Can hospitals shift costs?

- Monopoly is private sector.
- Assume there is one public sector program. Reimbursement levels are given.

Scenario 1: reimbursement level $>$ marginal cost at all times

- Government lowers reimbursement level to R'
- Profit is down in public sector.
- Should hospital raise price in private sector?
- Already at profit max in private sector – can't make more profit there

Can hospitals shift costs?

Scenario 2: reimbursement level falls below MC

- Government lowers reimbursement level to R''
- Loss in public sector.
- If loss in public sector is greater than profit in private sector, this hospital will close.
- Demand will go up for next nearest hospital.
- Profit from private sector will go up for that hospital.
- Price also goes up. $\longrightarrow$ Not cost shifting, but rise in price.

Excess Demand in Nursing Homes

It is argued that the reason for poor quality in nursing homes is because of excess demand – more people need care than providers available.

Excess demand is easy to fix for 2 reasons:

1. If homes make a profit, new firms should want to enter the market, and drive down price. Why isn't this happening?

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1. If homes make a profit, new firms should want to enter the market, and drive down price. Why isn't this happening?

- Certificate of need laws restrict new homes from opening; if excess demand, then medicaid costs are lower

Excess Demand in Nursing Homes

2. Should shrink if reimbursement rate rises.
   - home will select private patients whose marginal revenue exceeds reimbursement rate (instead of MC)
   - then take all public patients until reach capacity (this is main difference from cost shifting graph)
   - at capacity, marginal cost goes to infinity
   - demand for public beds is fixed
   - when reimbursement rate goes up:
     - private patients fall (their demand goes down)
     - public beds goes up
     - ED goes down

Assignment

- Read Ch. 13
- Homework 2 due in one week