

Economics of the Health Industry

Several years ago the Ford Foundation commissioned a series of three volumes to explore the economics of health, education, and welfare, respectively. Its inspiration came from a recognition of the ever-growing expenditures (now more than \$100 billion per year) devoted to these activities and their critical importance to the well-being of individuals and society. But perhaps even more important, the Foundation's hope was to open up the lines of communication between economists and those who have operating responsibilities for public programs.

The long-standing failure of economists to devote any appreciable intellectual resources to the study and analysis of health, education, and welfare activities defies easy explanation. Presumably, tradition and the not inconsiderable difficulties of conceptualization and quantification are partly to blame. But of at least equal importance is the persisting notion that because expenditures on these activities have large and important non-monetary aspects, they are not susceptible to rigorous economic analysis. Whatever the reasons, hard economic choices must be made continually in allocating scarce resources among a wide variety of competing needs, not the least of which are health, education, and welfare.

In this third and final volume of the series, **The Economics of Health** (Columbia University Press, New York, 1965. 208 pp. \$3.95), Herbert Klarman, of the Johns Hopkins University, attempts to define the economics of health, to present a comprehensive survey of the health-economics literature in relation to the mainstream of economic analysis, and to touch on important and newly emerging work in the field.

The survey itself is cast within the framework of an industry study, with attention to the demand for health ser-

vices by individuals, business, philanthropy, and government; the supply of personnel and facilities which provide health services; and questions of organization (individual versus group practice) and of the regulation of costs and quality of service. An effort is made throughout to assess the state of knowledge as well as to suggest the policy implications of various practices. For those who wish to follow up particular lines of inquiry, a useful 230-item bibliography is included.

As Klarman points out, there are any number of areas in which additional work is needed. For example, one of the most interesting issues of policy concerns the adequacy of the supply of health personnel, notably physicians, for whom demand is expected to rise sharply in the near future. A wide variety of methods have been employed to estimate physician "needs," as a basis for devising measures to help augment supply. Although the author sees the existence of a broad consensus that more physicians will be needed, and that from 10 to 30 new 4-year medical schools will be required to train them, he concludes that "... the bases on which the consensus was reached are not evident."

Such examples make it clear that those who work in the field of health economics have frequently found it difficult to separate out their *analysis* of "what is" (that is, how the market for health services actually functions) from their *view* of "what ought to be" (that is, how the market for health services should function). While "needs" are not unimportant in some broader sense, the economic basis for policy must rest on an understanding of how and why the market functions as it does.

There may be some disagreement with the author's suggestion that the market for health services has special characteristics which sharply distin-

guish it from other markets. Among these special characteristics, Klarman lists lack of knowledge, external benefits, the uneven and unpredictable incidence of illness, the investment and consumption elements of health expenditures, and so on. But the entire repair industry, in which people seek better "health" for their autos, homes, and other possessions, has many of these same characteristics. Thus, there must be a still more fundamental difference, and indeed there is. In the health industry it is the individual's ability to go on deriving the satisfactions of life, by virtue of decreased morbidity and increased longevity, which is at issue. In the repair industry, it is a matter of the individual deriving more or less satisfaction with the aid of specific material goods. The stakes are clearly quite different, and this it would seem is the crux of the matter.

Several of the most intriguing issues receive treatment in the concluding section of the book. One concerns the construction of the index of health care costs—namely, how to adjust the data on health expenditures to reflect improvements in the quality of health services. Should we price units of input (for example, the rise in the cost per day of a hospital bed) or units of output (for example, the shorter hospital stay which, owing to the availability of new drugs and procedures, is now required to recover from a given illness)?

Another issue relates to the economic evaluation of the costs and benefits of different health programs. What are the resource costs and the productivity benefits that result from attempts to eradicate or reduce the incidence of one disease contrasted to those made with respect to another disease? Or put another way, might it be more efficient to conquer first heart disease and then cancer, or the other way around? Issues such as these beg for more analysis by economists.

Klarman has done admirably in the difficult job of summing up, for both economists and noneconomists, what is known about the economics of health. Now we can only hope that economists will be challenged to start filling some of the vast gaps in our knowledge of this important subject.

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