Supply side of healthcare market

Who is the residual claimant of not-for-profit hospitals?

HS 156: Economics of Health & Education

‘Profit’ of not-for-profit hospitals

- Not-for-profits can and often does make a profit in the sense that its revenue exceed its costs

What becomes of the profits?

- Some models say doctors have seized control of the hospital and operate it to enhance their own profits
- Some say that hospital administrator (board) operates the hospital to increase its own happiness
- Some say that the hospital uses its profits to raise wages of employees above normal levels, in effect being captured by the “nurses”
- The legal charter of the hospital as a not-for-profit entity at least hints that “profits” will be returned to patients in the form of lower prices

Most likely, none of the proposed answers to this problem are wholly correct or wholly wrong.

Everybody associated with the hospital has a finger in the pie.

Who gets the bigger slice varied from place to place and time to time.

But let us look at each of the relevant actors and their roles in control of the hospital resources

Doctors as residual claimants

- An overwhelming view is that the doctors win-it-all. This model has obvious appeal, given the central role of doctors in directing the use of hospital resources.

However, there are difficulties in fully accepting this model

1. If that is so, why don't the doctors just directly own the hospital and this eliminate the ambiguity arising from the existing situation?

One answer to the question might be that the not-for-profit law confers tax advantages on the hospital that can be passed on to the doctors, enhancing their profits.

2. Doctors cannot win-it-all because we cannot treat all medical staff as homogeneous, operating with unified goals as a single entity. The assumption that doctors divide up the hospital's profits in even proportion to their own amount of work is erroneous.

Specialists of one area – for example, infectious disease – have very different ways to enhance their own profitability than, for example, paediatricians or heart surgeons.

Although all heart surgeons may have a single opinion regarding certain procedures, paediatricians may have different views keep their objectives in mind.

How will the hospital resolve conflicting claims?

Doctors as residual claimant model does not confront the question of choice between conflicting objectives of various medical staff members.

Administrator as residual claimant

- The “administrator” or the “board” in the prototype organisation is said to control the hospital in such a way as to maximize their own utility, much in the fashion of a consumer.
- The “board” (decision maker) is shown as gaining utility from quantity and quality of output.
- Rather than having a budget constraint (as would a consumer), the hospital faces a market constraint (the demand curve for its services) and a production constraint (the technical ability to combine inputs into producing output).
- In the usual fashion of a maximizing decision maker facing constraints, the hospital decision maker trades off quality and quantity in such a way as to maximize utility.

Where does the utility function come from?

Only if we accept the existence of such a central decision maker with a stable utility function, then this model is helpful & this approach has considerable appeal.

Employees or patients as residual claimants

- Some studies suggest that the hospital deliberately pays its employees more than market wages, either because it wants to or because the employees have forced it to.
- The hospital might do this either because of a powerful employees' union (or other strong bargaining position) or because the administrator "wants to."
- Another view is that hospital returns any profits to patients in the form of lower prices, simply by not collecting economic profits that it might have achieved.
- If one takes the legal form of not-for-profit at its face value, benefit to patients is the most desired choice of policy makers who establish not-for-profit structure.
- However, patients can gain only in the absence of other residual claimants.

If the decision maker's utility function includes quantity of output, then lower prices offer one way to achieve this.

Because patients respond to lower prices by demanding more care, lower prices might also directly improve "administrator" well-being.