

May 6, 2020

The Health Externality

As states begin to re-open, there are major questions about “how soon” and “how fast”. In your blogger’s home state of Michigan, there has been major and sometimes dangerous (armed confrontations at the State Capitol) discord. The simple argument seems to be that the problem is in Southeast Michigan (the Detroit metropolitan area), so why should the rest of the state suffer. Politics is never very far below the surface, and a strong-willed Democratic Governor has been opposed by a Republican-controlled Legislature.

If each of Michigan’s 83 counties were an island, each could pretty much do what it wanted, without repercussions. However, health, measured here through contagion, is an externality. It affects those who have it, but even more so (it seems) those who with whom they come in contact. Michigan’s counties (as are the counties in other states) are connected by commerce.

Michigan is well defined by two major Interstate highways. I-75 (starting in Florida) enters Michigan from Toledo, Ohio and goes north to Sault St. Marie in the Upper Peninsula. Cross-country Highway I-94, starting in Billings, Montana, enters Michigan from Chicago and Indiana, and goes through the state to Port Huron, with Canadian exits at Detroit and Port Huron. Contagion jumps into a car, truck, bus, or train and goes where the conveyance goes, up I-75 and across I-94. Northern Michigan is a beautiful area, with lots of summer traffic from Detroit and Chicago. Interviews with participants in the tourist industry, as well as other participants in the business community reveal a deep division – they want the commerce and they fear the disease.

In 2000, partnering with Miron Stano, your blogger wrote an article about the health externality with regard to managed care organizations (MCOs). We showed that good health was a positive externality, but acting separately, the managed care system was likely to provide “not enough care” to “not enough people”. This would occur because the MCO could not internalize the improved health, and would not be able to take advantage of the reduced costs. Consolidating into larger groups, and possibly global budgets constituted an important health care and policy solution. It would reduce costs, and improve health.

Revisited in this (COVID-19) year 2020 the model implies that “good health” is too important for community and county-level decision making. Places that are connected economically are also connected by contagion. Opening up Traverse City, Petoskey, and Charlevoix (beautiful cities up at the top of “the Mitten”) is only good if it improves commerce without bringing in contagion from elsewhere. No one yet seems to have a good idea of how to do that. There are only limited hospital facilities north of the Saginaw-Bay City-Midland area, and a contagious outbreak would have major consequences.

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Goodman and Stano's model speaks to the internalization of the health externality through "large area" regulation. Michigan, Ohio, Indiana, Kentucky, Illinois, Wisconsin, and Minnesota have sought to work together to coordinate policies and re-opening plans. That scale seems about right. With what we know now, counties, and even larger districts within states, and possibly even the state boundaries themselves, are too small.

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Reference

Goodman, Allen C., and Miron Stano, "HMOs and Health Externalities: A Local Public Good Perspective," *Public Finance Review* 28 (3), May 2000, 247-269.
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