
The Theory of Social Health Insurance

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Peter Zweifel

*University of Zürich
Socioeconomic Institute
Hottingerstr. 10
CH-8032, Zürich
Switzerland
pzweifel@soi.unizh.ch*

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Peter Zweifel*

*University of Zürich, Socioeconomic Institute, Hottingerstr. 10 CH-8032,
Zürich Switzerland, pzweifel@soi.unizh.ch*

Abstract

The objective of this text is to develop the theory of social health insurance (SHI; the expression used especially in the United States is “public health insurance,” which will be viewed as one variant of SHI here). While a good deal is known about the demand and supply of private insurance, the theoretical basis of SHI is much more fragile. Specifically, on the demand side, what are the reasons for social (or public) health insurance to exist, even to dominate private health insurance in most developed countries? With regard to supply, what do we know about the objectives and constraints of SHI managers? Finally, economists can predict properties of the equilibrium characterizing private health insurance (PHI). However, what is the likely outcome (“performance”) of SHI? At the normative level, one may ask, Should the balance be shifted from SHI to PHI?

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1

Introduction and Overview

The objective of this text is to develop the theory of social health insurance (SHI; the expression used especially in the United States is “public health insurance,” which will be viewed as one variant of SHI here). While a good deal is known about the demand and supply of private insurance, the theoretical basis of SHI is much more fragile. Specifically, on the demand side, what are the reasons for social (or public) health insurance to exist, even to dominate private health insurance in most developed countries? With regard to supply, what do we know about the objectives and constraints of SHI managers? Finally, economists can predict properties of the equilibrium characterizing private health insurance (PHI). However, what is the likely outcome (“performance”) of SHI? At the normative level, one may ask, Should the balance be shifted from SHI to PHI?

Accordingly, the outline of this text is as follows. Section 2 starts by reviewing the conventional theory of demand for insurance and health insurance in particular. However, it also seeks to offer explanations of the demand of SHI, citing efficiency, public choice, and equity reasons. They may explain the existence (but not necessarily the prominence) of SHI. Section 3 is devoted to the supply of health insurance in general

2 *Introduction and Overview*

and SHI in particular, which comprises more dimensions than just price and quantity. Section 4 reviews the properties of the optimal health insurance contract for providing a benchmark especially with regard to combating moral hazard. In Section 5, the question is asked whether there are factors limiting the apparently inexorable growth of SHI. Section 6 offers a summary and concluding remarks.

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