Competition as an All-Purpose Remedy for Medical Care and Health Insurance

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FTC/DOJ Hearings on Health Care Competition Law and Policy

The Basic Question

- Competition improves welfare in the Econ 101 model. Will it work as well in medical services and health insurance markets?
- My answer (so far): Most of the time, yes. The exceptions can be identified in advance.
- I will give competition the benefit of the doubt in what follows. There are qualifications for most statements.

Which Markets?

- The market for medical services and goods.
- The market for health insurance.
- With 86% of health expenditures paid by third parties, the two markets are inextricably intertwined.

Some Differences from the Widget Model that Might Matter

- Product quality is variable.
- Consumers are imperfectly (and asymmetrically) informed.
- Insurers set (“administered”) prices.
- Some suppliers are not-for-profit.
- Insurers with market power may face providers with market power.

Definitions and Postulates

- By “competition” I mean free entry by many firms subject to a breakeven constraint.
- I am a congenital economist, so I judge arrangements by whether or not they maximize the some of consumers’ and producers’ surpluses—net welfare.
- Theory of 2nd best: more competition is not necessarily best if there are other imperfections.

What “Competition” Alone Can Never Do.

- Get all or even most of the uninsured insured.
- Stop the real growth in medical care spending. Best hope is a one-time cut.
- Lead to optimal rates of product innovation.
- Maximize quality or minimize errors.
- Frustrate the exploitation of non-existent economies of scale.

Competition and Product Quality.

- Competitive markets at best minimize price for a given quality and choose the optimal quality (where MB = MC). This not even guaranteed.
- Compared to its absence, the introduction of competition will reduce price or improve quality, but not necessarily both.
- Because quality can be too high or price too low under imperfectly competitive conditions.

Competition Under Administered Pricing I

- Suppose some large buyer sets the price for a product of variable quality and forbids or deters balance billing.
- The basic model: the regulated airline industry "pub lounge" wars: competitors compete away surplus in "qualities" that attract business.
- Excess quality only holds if price is "too high."

Competition Under Administered Pricing II

- Some evidence of this for Medicare: dialysis centers and Medicare HMOs.
- May have applied to hospitals in the old "arms race" world.
- An improvement: competition is better for consumers.
- An ideal: But the best would be to get rid of administered pricing or set optimal prices

Imperfect Consumer Information I

- Can lead to monopolistic competition even with free entry, but what are you going to do?
- The best solution: the best information, and competition.
- If uninformed consumers overdemand, monopoly may improve efficiency.

Imperfect Consumer Information II

- The most recent manifestation: the medical errors controversy stirred up by the IOM.
- If there are reducible medical errors, why? What's their problem?
- What's the solution: Compassionate conspiracy of right thinking providers or informed competition?
- Answer this empirically. What info.?

Insurance in a World of Provider Monopoly I

- Insurance can cause overconsumption because of moral hazard.
- This is only a problem (that can be solved) if insurance is excessive—but it probably is.
- Remove the tax subsidy rather than tolerate monopoly. More efficient and more just.

Insurance in a World of Provider Monopoly II

- Suppose providers have market power? Is it efficiency-improving if insurers have countervailing power (monopsony)?
- It can be, but only up to a point.
- Need upward sloping supply curve for monopsony to be possible.
- Monopsony helps buyers less than it hurts sellers.
- A consumers' cartel would maximize consumer but not total welfare.

Not-for-Profit Firms I

- In competitive markets, all firms are non-profit.
- Evidence does not suggest much difference among hospitals; may be diffs in other services (+) and insurance (-).
- Few realized economies of scale or scope.

Non-Profit Firms II

- Monopoly is bad if NFP is for-profit in disguise or doctor's workshop.
- What if the price is set at the monopoly profit maximizing level but the profits are used for good works? A bad way to do a good thing.
- Other models predict high prices and excessive quality.

Conclusion

- Medicare services and health insurance are not so different after all. People are people.
- While there are some differences, more competition is usually the best medicine.
- When it isn’t the best medicine taken alone, it usually is the best if combined with something else.