

Countervailing Power in Health Care Markets

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Introduction

◆ Outline

- Countervailing power - what is it?
- Why might it matter in health care markets?
- Background
- What does economics tell us?
- Practical matters
- Conclusion

Countervailing Power - What Is It?

- ◆ This term is often used in a vague way.
- ◆ Definition
 - The establishment (or existence) of market power on one side of a market where market power already exists on the other side.
 - ◆ Examples
 - Labor Unions
 - Retailers

Why Might It Matter in Health Care Markets?

- ◆ Market power on 1 side of the market.
 - Insurer monopsony power.
 - Provider monopoly power.
- ◆ Market power causes consumer harm, regardless of monopoly or monopsony.
- ◆ The exercise of market power on one side of the market is a necessary condition for this to matter.
- ◆ Can countervailing power improve matters?

Background

- ◆ Notion and term due to Galbraith (1952).
 - Power of seller checked, not by other sellers, but by strong buyers.
 - Existence of market power on 1 side of a market will provide an incentive for the other side of the market to organize to obtain market power.
 - Never rigorously developed.

What Does Economics Tell Us?

◆ Basics

- Competition is best.
- If market power exists on one side of a market, best policy is to remove it.
 - ◆ Criterion for “best” is social welfare.
- In this situation price levels are uninformative about welfare.
 - ◆ Do “low” prices result from monopsony power or competition?
 - ◆ Do “high” prices result from monopoly power or competition?

Economics, cont'd.

- ◆ What if there is market power on one side, and it can't/won't be removed?
 - Can creating market power on the other side of the market improve matters?
- ◆ Answering this question is not easy.
 - There hasn't been much work in economics on this topic.

Economics, cont'd.

- ◆ Price theory isn't helpful.
 - This is a bargaining problem.
 - Price theory not well suited for analyzing this problem.
- ◆ Modern economic theory better suited to shedding light on this issue.

What Do We Know From Theory?

- ◆ Two main possibilities.
 - Countervailing power allows the possibility of a cooperative bargaining outcome.
 - ◆ This can achieve the first-best.
 - Countervailing power always makes things worse than market power on one side of the market.
 - ◆ A cartel can only exercise market power by restricting quantity to the other side of the market.

Evidence

- ◆ General
 - Mixed – unreliable.
- ◆ Health care
 - Not many studies.
 - Health care prices are lower in more concentrated health insurance markets.
 - ◆ Not relevant to the issue.

Practical Questions

- ◆ Does market power exist on one side of the market?
 - Do insurers have monopsony power, or do providers have monopoly power?
 - Does this reduce social welfare?
 - If not, “countervailing” power is creating market power on 1 side of the market where there was none.
 - ◆ Unequivocally welfare reducing.
- ◆ Examination of quantity traded is key.
 - Price impacts are not revealing.

Conclusions

- ◆ Countervailing power is a live issue only insofar as there exists significant loss of social welfare due to market power on one side of a market.
- ◆ Health care markets are local, so this must be considered on a market by market basis.

Conclusions, cont'd.

- ◆ If there is a loss due to market power on 1 side of a market directly addressing that is best.
- ◆ If redress to market power on 1 side is not possible, countervailing power may improve or worsen matters.
- ◆ Clear that a blanket exemption is inappropriate.