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CENTER for STUDYING HEALTH SYSTEM CHANGE

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Potential for Price Competition Limited in Many Local Health Care Markets

Consumer Demand for Broad Choice; Provider and Insurer Concentration Blunt Competitive Forces

WASHINGTON, D.C.—When employers retreated from tightly managed care, they unwittingly dampened competitive forces to cut costs and improve quality in local health care markets, especially in communities with significant hospital consolidation, economist Paul B. Ginsburg, Ph.D., president of the Center for Studying Health System Change (HSC), told federal antitrust officials today.

"The fallout of the retreat from tightly managed care continues to shape competition in many local health care markets today, leaving limited prospects for competition to reduce costs and increase quality," Ginsburg said at a joint hearing of the Federal Trade Commission and U.S. Department of Justice examining health care competition issues.

As part of HSC's Community Tracking Study, researchers conduct site visits and interview health care leaders in 12 nationally representative communities every two years. HSC, a nonpartisan policy research organization funded exclusively by The Robert Wood Johnson Foundation, is currently conducting its fourth round of visits to Boston; Cleveland; Greenville, S.C.; Indianapolis; Lansing, Mich.; Little Rock, Ark.; Miami; northern New Jersey; Phoenix; Orange County, Calif.; Seattle; and Syracuse, N.Y.

"We're observing some real limits to competition that are outside the scope of antitrust review," Ginsburg said.

"In an ideal world, consumers would have information to help them make informed choices about the trade-offs among the cost, quality and accessibility of their health care," Ginsburg said. "You can't have competition on price and quality when there's little consumer awareness of price and almost no comparative quality information, and that's the world that exists in many communities today."

In the early and mid-1990s, managed care plans—in response to employers' requests to slow rapidly rising health care costs—limited patients' choice of physicians and hospitals, required prior approval for certain high-cost services and restricted physicians' clinical authority. Health plans also expanded rapidly and demanded deep price discounts from providers in return for inclusion in plan networks. To compete for managed care contracts, many hospitals banded together in systems, leading to increased hospital consolidation in many markets.

But consumers disliked restrictions on their care, prompting a powerful backlash. Competing to attract and retain workers in a tight labor market during the economic boom of the late-'90s, many employers moved away from insurance coverage with limited provider choice and care restrictions. Many health plans expanded provider networks and eased restrictions on care by eliminating prior approvals for specialty referrals and certain tests and procedures. With fewer administrative controls on the use of

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medical services and plans' ability to negotiate discounted fees hampered, health spending and insurance costs again began rising rapidly.

At the same time, health plans, which had earlier expanded rapidly and competed fiercely on price to attract new business, began exiting unprofitable markets, decreasing competition among insurers in many local markets.

With tightly managed care in retreat, hospitals are under less pressure to compete on price, and many are now vying for market share with aggressive advertising campaigns targeting lucrative specialty services such as cardiac and cancer care. In some markets, there are signs of a new medical arms race as hospitals build new specialty facilities. Increased demand for care also has left many hospitals with less excess capacity and more leverage with health plans. Generally, physicians have had less success in gaining leverage over health plans with the exception of some single-specialty groups.

According to HSC research, growing use of inpatient and outpatient services accounted for about two-thirds of the 12 percent increase in spending on hospital care in 2001 for privately insured people, with the other third coming from higher payment rates, thanks, in part, to hospitals' increased bargaining clout with health plans. But hospitals are facing significant financial pressures from rising wage rates in the face of a severe shortage of nurses and other skilled employees. The average hourly hospital wage grew 6.1 percent in 2001—nearly double the 2000 pace.

"There's evidence of moderately higher trends for hospital prices, but hospitals are facing significant financial pressures," Ginsburg said. "The main reason hospital spending is increasing so rapidly is increased use of services, and hospitals are racing to build capacity and advertising their services to attract patients."

A copy of Ginsburg's presentation is available online at *www.hschange.org.*

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The Center for Studying Health System Change is a nonpartisan policy research organization committed to providing objective and timely research on the nation's changing health system to help inform policy makers and contribute to better health care policy. HSC, based in Washington, D.C., is funded by The Robert Wood Johnson Foundation and is affiliated with Mathematica Policy Research, Inc.