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.