NO KIDDING - UPMC/CHILDREN'S MERGER IS BAD FOR THE REGION

Martin Gaynor*

Highmark and a number of other insurers have sued to block the merger of Children's Hospital with UPMC. It should be clear why the insurers fear such a merger -- they view it as a threat to their profits. What may not be so clear is that the merger is also bad for the region. At best it's bad for business, bad for workers, and bad for consumers. Indeed, it may be a disaster in waiting for the region. Here's why.

Southwestern Pennsylvania already is burdened with some of the highest health care costs in the United States. As an economist, the reason is straightforward – our market for healthcare is far from being close to the ideal of perfect competition. Highmark is a giant dominating the health insurance market. UPMC is dominant in the hospital market. Health care in Southwestern Pennsylvania involves a face-off between these two behemoths.

A UPMC/Children's merger will only worsen this lack of competition. Children's Hospital is a world-class institution, and the place many of us want to be able to send our children should they need care. As a consequence, Children's is an essential component of any health insurance plan's provider network. A health plan that does not cover care at Children's Hospital will have a tough time in the marketplace.

Most likely, UPMC's acquisition of Children's will greatly increase its power in the Southwestern Pennsylvania health care marketplace. This is to the disadvantage of health insurers, who may end up having to pay higher prices or accept package deals with the UPMC system that they don't want. This is to the disadvantage of other hospitals in the region, who are now at a competitive disadvantage.

But it is all of us – workers, employers, and consumers – who will really be hurt. If prices go up to health insurers those costs will be passed on to employers. Research shows that a dollar increase in health care costs to employers results in a dollar decrease in workers' wages. So any increased costs will ultimately come out of workers' pockets. In addition, there is evidence that quality of care suffers after hospital mergers -- another reason to be concerned. Higher costs, lower wages, and fewer chances of attracting new businesses to the Pittsburgh region will be the result.

Further, there's another, very important, concern for the region. That is whether this merger is good for UPMC's health. UPMC is a vital, valuable resource for the Pittsburgh region. UPMC has been involved in many mergers and acquisitions over the past few years involving significant outlays of cash. While the institution's financial health appears fine from the outside, so did Allegheny General's up until the bankruptcy was announced. The region cannot afford for what happened to Allegheny General to happen to UPMC.

So what should we do? In many ways, this merger may be for health care what restructuring has been for electricity in California. Because of its unique character, Children's Hospital has the characteristic of an essential facility. In essence, because it is critical to the provision of high quality health care in Southwestern Pennsylvania, Children's has the same properties as telephone lines or power transmission. Telephone and power companies are required to provide access to these facilities to competitors at a reasonable cost. One solution is to require that, if UPMC acquires Children's, it should also provide access at cost. Indeed, a big part of the problem in California's electricity market is that when utilities sold their transmission capacity to private companies, those companies were not required to sell power back to the utilities at a reasonable cost.

A better solution would be to ban the merger. Even so, we should not pretend that banning this merger will leave us with a perfectly competitive market in health care. More careful regulatory oversight is needed than has been previously exercised in order to make this market work more effectively.

Markets require rules to work. Another word for those rules is regulation. A common fallacy is that markets and regulation represent two polar opposites. This is not true. Effective markets require regulation in order for them to work. The health care market for this region has is dominated by two behemoths in health insurance and hospitals – and the region suffers as a consequence of high medical costs. We have seen the consequences of inadequate attention to market rules and regulation in the California electricity market. Let's not make that same mistake with health care here.

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