Center for American Progress

A Perfect Storm

Why approving the Highmark/IBC merger will damage the Pennsylvania economy and set it on the wrong direction for health care reform

Certainly no other issue is as critical to millions of Pennsylvanians, and all Americans, as health care reform. The United States spends almost twice as much as any industrialized country on health care, but the results for that health care are marginal in many respects. The number of uninsured has reached record levels—one in seven Americans. And health insurance premiums have increased by over 87 percent in the past five years, outpacing the growth of other health care costs.[1] It seems the only entities that profit from this health care crisis are large health insurance companies.

The broken health care system has tremendous consequences for our economy and efforts to reverse the economic downturn. One of the central reasons for U.S. automakers' demise is the substantial competitive disadvantage they suffer because of rising health care costs. Rising health insurance premiums force employers, especially small employers, to face the difficult choice of cutting benefits or laying off workers. And these problems are expected to get worse; premiums are expected to increase by 20 percent in the next four years, which could cost 3.5 million more jobs and decrease incomes by over $1,700 a year.[2]

The Pennsylvania Insurance Commissioner will make a decision early this year that could permanently transform the health care marketplace in Pennsylvania. The commissioner will decide whether to approve Highmark's proposed merger with Independence Blue Cross. The commissioner has received a mountain of submissions in the extensive legislative and regulatory hearing processes, but two recent developments significantly raise the competitive threat of the merger. The recent, severe economic downturn and the recognition of the general weakness of health care industry regulation highlight the significant dangers associated with approving this merger. Most significantly:

- **A monopoly health insurer would derail health care reform.** The new administration and governors in every state recognize the need for health care reform as costs, especially for insurance, spiral out of control. Creating a single monopoly health insurer will disable Pennsylvania's health care reform efforts and significantly increase costs to the commonwealth.

- **The merger would put Pennsylvania at a competitive disadvantage as the economy worsens.** Pennsylvania, like practically every other state, has suffered substantial job losses since the Insurance Department's hearings were held. The ability to sustain, attract, and grow businesses depends on an effective and competitive health care system. Approving the Highmark/IBC merger, which will lead to higher health insurance prices, will place Pennsylvania businesses at a significant competitive disadvantage.

- **Highmark's size will make it difficult to regulate.** The Highmark/IBC merger will create the largest health insurer in Pennsylvania and the largest Blue Cross plan in the country. Highmark has responded to competitive concerns saying that they are carefully regulated and the insurance commissioner will prevent any harm to consumers. Yet if the past several months have taught us anything, it is that regulators are imperfect, often deceived, and have tremendously limited resources. The Highmark/IBC merger will create an insurance giant that will create unprecedented regulatory challenges.

- **The merger will create a company that is too big to fail.** Every day we are bombarded by new examples where the government has to spend taxpayer resources to bail out firms because they are "too big to fail." Billions of taxpayer dollars are being spent to rescue mismanaged giants in the banking, insurance, financial service, and automobile industries. If this merger is permitted, Pennsylvania will become dependent on a health insurance giant, which would know it now falls into the prized class of "too big to fail." If anything were to go wrong through Highmark's mismanagement or simply market forces, the commonwealth would be compelled to bail them out. Indeed, the state of Michigan faces this precise problem—it permitted Blue Cross of Michigan to become the state monopolist, and now Michigan taxpayers are faced with bailing out Blue Cross for years of mismanagement.

For all these reasons, the insurance commissioner should reject the merger.

A monopoly health insurer would derail health care

Health care reform stands near the top of President-elect Obama's domestic and economic policy agenda. And for good reason: health care costs are the costs that are most rapidly increasing expense for many businesses, especially small businesses, and they are difficult to control. Moreover, the cost of handling health care expenses for the uninsured and underinsured is crushing most state government budgets.

President-elect Obama has singled out health insurance mergers as a major culprit in deterring efforts to address increasing health care costs. He specifically criticized the Justice Department for taking a lax attitude toward health insurance mergers, noting that, "there have been over 400 health care mergers in the last 10 years, and … 95 percent of insurance markets in the United States are now highly concentrated." This concentration has led to higher prices, more anti-consumer insurance provisions, greater payment delays, less coverage, and poor service.[3]

The Highmark/IBC merger will magnify these problems in Pennsylvania. It will create a single health insurer with almost 70 percent of the Pennsylvania market and a stranglehold in the two largest metropolitan areas: Philadelphia and Pittsburgh. Both Highmark and IBC are financially strong, and Highmark in particular has been expanding into new territories. IBC has by any measure a monopoly position in southeastern Pennsylvania. But for this merger, Highmark would compete in Philadelphia. Just as Highmark's invasion of central Pennsylvania six years ago forced Capitol Blue Cross to compete harder, lower prices, and improve services, Highmark's entry into Philadelphia would have a similar result with significant direct savings to consumers that could easily exceed $3 billion over the next six years.

The insurance commissioner's own experts have recognized that prices would be lower if the state declined the merger. They noted that there is a "great deal of evidence to suggest that competition between Highmark and CBC has benefited health care customers in central Pennsylvania" and the experts analysis showed that Highmark's entry demonstrated "a significantly lower premium in central Pennsylvania versus western Pennsylvania during the years immediately following Highmark's entry into the central area."[4]

So it seems straightforward that the merger will lead to higher prices for employers and unions, and consequently higher prices for consumers. More employers will be unable to provide insurance, increasing the number of uninsured.

But this merger will cost more than simply higher premiums and diminished service. Any health care reforms likely to be enacted by Congress in the next few years will rely heavily on health insurance companies for financing and payment. Competition between health insurance companies in each state will be critical to controlling costs.

For example, states heavily depend on private health insurers for numerous government-sponsored programs, especially for the elderly. When the federal government typically envisions these programs, it assumes that there exists a competitive insurance market with several competitors (at least 4-5) and relatively easy entry. But if the Highmark/IBC merger is approved, the Philadelphia area, and probably soon thereafter the entire commonwealth, will become "fortress Highmark." And when it comes time to initiate new health care programs or enact health care reform, it will be Highmark and its 70 percent market share rather than the commonwealth that will call the shots.

The states that will prosper during the forthcoming health reform challenges are the ones with meaningful insurance competition. Reform will falter in those states with few insurance rivals. While all other states are able to reduce costs and improve services through health care reform, Pennsylvania will lag behind.

The merger would put Pennsylvania at a competitive disadvantage as the economy worsens

Pennsylvania, like almost every other state, faces an increasingly severe economic crisis. Unemployment has increased substantially, new job growth has dwindled, and the budget deficit for fiscal year 2009 is estimated to be in excess of $1.6 billion.

Health insurance costs have a clear effect on employers' ability to compete. Higher health insurance premiums translate directly into higher labor costs, which force employers to cut back their workforce. Recent studies have demonstrated that a 20 percent increase in health insurance premiums would cost 3.5 million workers their jobs, lead a similar number of workers to move from full-time to part-time work, and cut average annual income by $1,700. It is currently anticipated that nationwide premiums will increase by 20 percent in the next four years, and that rate will only be worse in a state dominated by a single insurance company.[5]

Higher premiums primarily translate into lower wages over time, particularly for those workers most likely to incur higher health care costs. Rising health care costs will drive up taxes and premiums, eating up 95 percent of the growth in per capita gross domestic product between 2005 and 2050.[6] Older industries are particularly burdened by the cost of health coverage for their workers and retirees. American manufacturers are paying more than twice as much on health benefits as most of their foreign competitors (measured in cost per hour).

Highmark has suggested that the merger will benefit the commonwealth through apparently impressive costs savings of a billion dollars. Some of these savings come from consolidating overhead or combining pharmaceutical purchases. But appearances can be deceptive, and certainly are in this case. Those proposed cost savings seem too good to be true, and for good reason—no Blue Cross merger has ever achieved savings at any comparable level. In fact, a study of recent Blue Cross mergers demonstrated that there were relatively paltry savings achieved, regardless of the optimistic savings projected by the mergers. In some cases no significant costs savings were achieved or expenses actually increased. Even the insurance commissioner's experts found numerous reasons to fault Highmark's estimates as inflated.

But the costs to the commonwealth will overwhelm any projected costs savings. First, there is the cost of the competition lost because, but for the merger, Highmark would enter southeastern Pennsylvania and compete with IBC. That would create the type of competition businesses and consumers in central Pennsylvania have enjoyed for years. Simply, if the merger did not occur, southeastern Pennsylvania businesses would see a drop in health care costs that would be an added boost to their ability to stay afloat and compete—possibly billions of dollars in premium reductions.

The merger will lead to higher health insurance premiums. As those premiums increase, employers, especially small employers, will face the difficult choice of cutting back coverage or reducing their workforce. Employees will lose either way. The merger will increase costs for the commonwealth. The lack of health insurance competition will increase costs for those programs that are funded by the commonwealth and demand for even greater budget outlays. Pennsylvania's efforts to cut health care costs will be weakened as the commonwealth is forced to depend on a monopolistic insurer. The figurative tail will be wagging the dog.

A last fault is that as Pennsylvania's health insurance costs increase relative to other states, it will lose in the battle to attract and secure new businesses. New businesses look at a variety of factors in deciding where to locate their businesses. This merger will lead to increasingly high-priced health insurance and a lack of choice, which will discourage businesses from locating or expanding in Pennsylvania.

These competitive concerns are not mere speculation. There is a direct relationship between insurance market concentration, rising health costs, and economic weakness. Michigan is the state with one of the most concentrated health insurance markets; Blue Cross has an almost 70 percent market share after a series of acquisitions. As their market share has increased, premium costs, especially to small businesses, have increased rapidly, outpacing the national rate of increase.

Controlling health care costs will be a vital component in the battle for businesses and jobs and in efforts to reverse the economic downturn. Yet Pennsylvania will fight with one hand tied behind its back if it permits the formation of a health insurance monopoly.

Highmark's size will make it difficult to regulate

Highmark promises that the merger will not lead to increased premiums or diminished service, and that it will instead result in significant costs savings to consumers. But these claims are dependent, at a minimum, on several enormously critical factors: substantial conditions on its complex operations and the insurance commissioner's ability to carefully police Highmark under these conditions. Yet there is every reason to doubt that anyone, no matter how dedicated or adequately staffed, can effectively regulate the giant created by this merger.

Let's begin with a fundamental principle critical to our free market economy: Regulation is typically a poor substitute for competition. Competition typically results in the best allocation of resources, a drive for efficiency, and cost containment. Economic history can fill volumes with examples where regulation did not achieve the benefits for consumers that come from competition. So no matter what Highmark promises, it will be a second-best solution to what would be achieved if Highmark and IBC continued as independent insurers. No form of regulation can replicate the cost savings and improved service that would arise when Highmark and IBC compete head to head.

Imagine for a moment that Highmark had decided not to enter central Pennsylvania, but instead decided to acquire Central Blue Cross. Is there any form of regulation that the insurance commissioner could have implemented that would have replicated the benefits of competition that were created by Highmark's entry into central Pennsylvania? How would the insurance commissioner have determined the proper level to decrease premiums or improve the level of coverage? That is why competition is almost always preferable to regulation.

The regulatory challenge that will be created if the Highmark/IBC merger is approved is daunting. Effective regulation is often a battle between the strength of the regulator and the "clout" of the firm being regulated. By creating a single health insurance giant, Pennsylvania will establish a single firm with almost unlimited market clout that will in turn translate into regulatory clout. After all, Highmark will have near limitless resources to fund lobbyists, experts, and lawyers to help influence the regulators and legislators. It will be able to credibly threaten to "go to the mat" on any issue. Regulators and legislators will have to pick their battles with extreme caution. As Highmark grows, regulators will find it increasingly difficult to monitor its conduct and challenge activity that threatens to harm consumers.

This is not mere speculation. The number of regulatory violations grew substantially after United Health Care acquired Pacificare in California. Now California insurance regulators face daunting and increasingly expensive regulatory challenges—albeit at a far smaller size than the proposed Highmark/IBC.

One clear lesson from the economic downturn is regulators' failure to effectively police various service-related markets. These failures have occurred because regulators are ill equipped to address industry giants' subtle market manipulation and deceptive practices. Similar problems could easily occur in health insurance where the regulator is also charged with ensuring the "safety" and "financial soundness" of non-profit insurers such as Highmark.

There is clearly a cost to the commonwealth and its taxpayers from the creation of a dominant health insurer. The state will have to significantly increase the insurance commissioner's budget to handle the new challenges of the combined Highmark/IBC. And that is an additional cost that the commonwealth can ill afford.

The merger will create a company that is too big to fail

Competition is critical to the functioning of a free market economy. Yet sometimes certain companies become far too large both in terms of their basic size and market share when antitrust enforcement is too docile. When firms become too large, the market cannot deal with their failure. If they have too large of a market share, the entire market will be harmed if they collapse. And in other cases, financial failure may have economic repercussions far beyond the scope of the specific market because of a firm's size and the type of services it provides.

Over the past few months we have learned the painful and enormously expensive lesson of permitting firms to become too large to fail. Hundreds of billions of taxpayer dollars are being spent to bail out mismanaged industry giants in banking, insurance, financial services, and other key markets—now including potential auto company bailouts. There seems to be no limit to the need to bail out these former industry giants.

The Highmark/IBC merger would create a health insurance giant that would be too big to fail. And there is only one entity available for this bailout: the Commonwealth of Pennsylvania and its taxpayers. If Highmark/IBC faced an economic downturn, or made bad investments or other poor financial decisions, would its executives lose any sleep? Probably not. They know that if serious financial problems arise they can simply raise premiums since there would be little competition to inhibit price increases. And if the going got really tough they could take out their "too big to fail" card at the Commonwealth of Pennsylvania ATM to rescue Highmark from any financial problems. After all, who would, or could, let a health insurer with a 70-percent market share fail?

This is not speculation. This is precisely the problem occurring in Michigan. Blue Cross of Michigan has become the dominant health insurer through a series of mergers. It, like Highmark, promised significant cost savings and no premium increases. Neither of those promises were worth the paper they were written on. Blue Cross' financial status has deteriorated and its financial losses have exceeded $100 million this year. It has gone to the state asking for a bail out that will make taxpayers pay for its mistakes.

The merger clearly raises the risk that the commonwealth will pay for Highmark's demise or financial losses. Assume for the moment that for some reason IBC failed financially. Although that would be an unfortunate outcome, Highmark could easily enter southeastern Pennsylvania and replace IBC. Consumers and taxpayers would suffer no significant harm.

But if Highmark were to face significant financial hardship after the merger, what alternative would there be? Could another insurance company step in and replace Highmark? That seems extraordinarily unlikely. The more likely outcome is that Highmark will come to the commonwealth and ask for a substantial bail out at consumers' expense.

By creating an entity that is too big to fail, the commonwealth will establish a taxpayer-sponsored safety net for Highmark that will potentially cost current and future Pennsylvanians billions of dollars.

Endnotes

1 Statement of Barack Obama to the American Antitrust Institute, September 27, 2007, available at http://www.antitrustinstitute.org/archives/files/aai-%20Presidential%20campaign%20-%20Obama%209-07_092720071759.pdf.

2 James Kvaal, "The Economic Imperative for Health Reform" (Washington: Center for American Progress, 2008), available at http://www.americanprogress.org/issues/2008/12/pdf/health_imperative.pdf.

3 Statement of Barack Obama to the American Antitrust Institute.

4 LECG Inc., "Economic Analyses of The Competitive Impacts from the Proposed Consolidation of Highmark and IBC" (September 2008).

5 Kvaal, "The Economic Imperative for Health Reform."

6 Ben Furnas, "American Health Care Since 1994: The Unacceptable Status Quo" (Washington: Center for American Progress, 2009), available at http://www.americanprogress.org/issues/2009/01/health_since_1994.html.