Pension and Health Benefits Committee

Agenda Item 7a

March 17, 2020

Item Name: Healthcare Competition: Background, Current Research, and Strategy Development

Program: Health Benefits

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Executive Summary

Substantial price variation exists across health care markets in California in part due to the lack of competition among providers – particularly hospitals and medical groups. Competition creates different but also critical issues when it comes to health insurers. Among providers, lack of competition leads to higher prices for services which, in turn, causes higher premiums. On the insurer side, the right mix of plans and plan types can maximize competition among insurers, as well as between insurers and providers, which increases competition and lowers prices. The wrong mix can have the opposite effect. CalPERS is researching the effects of insufficient competition within its health plan offerings and possible strategies to address it. The purpose of this agenda item is to update the Board of Administration on those efforts.

Strategic Plan

This item supports the CalPERS 2017-2022 Strategic Goal "Transform Health Care Purchasing and Delivery to Achieve Affordability."

Background

Health care costs continue to rise in California and nationally. Studies have shown that increasing prices, not utilization, are the primary driver of the increasing costs. Even though numerous studies have shown that cost is not associated with the quality of the healthcare received[1], the average price for the same service varies considerably across and within geographic regions. Nationally, prices for common services that are not likely to vary in quality or patient severity can differ by over two times in the same market[2].

Health care prices within California can also vary dramatically by geographic region. In 2016, uncomplicated childbirth prices were double in the Monterey region compared to the San Diego region, while a colonoscopy was 55% higher in the Sacramento region compared to Orange County[3].

This large variation in prices for the same services within a geographic area is largely explained by market forces. The bargaining strength of a hospital, provider group, or insurer is determined by the amount and type of competition in a region. A lack of competition can occur through geographic isolation, market consolidation, or other factors resulting in higher prices to payers.

Lack of provider competition

Studies have shown that areas with fewer hospital or physician groups often have higher premiums[4,5]. For CalPERS, prices tend to be highest in areas with limited hospital competition. Little or no competition among hospitals in a geographic region has been an historic challenge in select rural areas of the state, but it is not limited to rural areas. More recently, hospital consolidation, medical group consolidation, and mergers of hospitals and medical groups has also resulted in less competition and higher prices.

Hospital competition in California at the county level has remained low since 2010 and the competition among specialist and primary care providers has decreased[3]. Additionally, the number of physicians that work in practices owned by hospital or health systems increased by over 75% from 2010 to 2018[3]. In markets with fewer hospital choices, this type of consolidation was associated with a 12% increase in premiums, 9% increase in specialist prices, and 5% increase in primary care prices from 2013 to 2016[6].

A lack of provider competition, especially hospitals, can also result in depressing the wages of health care workers and distorting the labor market[7].

Insurer competition

Competition in California's health insurance market is generally strong in larger populated markets, particularly when compared nationally[8], where the two largest insurers in each market have 70% of the enrollees in over half of U.S. markets[7]. Nevertheless, in several northern and rural California counties, there is little or no competition. In 15 of the 58 counties, our members only have access to CalPERS PPO products, and cannot choose an HMO plan, which often provide care at a lower cost.

The issues related to insurance and provider competition also differ. While less competition can increase prices, more competition does not necessarily lower them. For instance, too many insurers in an area with low competition among providers can undermine insurer bargaining power with those providers, resulting in higher prices.

Research and strategies to address lack of provider competition

In order to control costs in areas lacking sufficient provider competition, CalPERS plans on conducting various research activities. These include understanding the cost drivers in a region at a granular level, e.g. procedures or episodes of care. Using this information, CalPERS can develop profiles and benchmarks of providers based on a market basket of health care to know how they compare. This information can help CalPERS and its insurers contain costs.

Various other strategies have been developed to address the lack of competition among providers in a geographic area. One strategy is to move some health care services outside of the area or move services outside of the hospital setting. These include:

- Centers of Excellence, which seeks to move members from high cost facilities to high value facilities for specific highly-specialized services. Large employers, such as Lowes and McKesson, have implemented this strategy for services such as heart, hip, and spine surgeries, where their members travel to a single or a few regional hospitals. This strategy has also been adopted by some labor union trust funds.
- When few providers are in an area, telemedicine can help address the issue. This has been especially true for mental health services in rural areas, where there is often little or no services offered[9]. But this can also increase competition for other common services provided by a primary care physician.
- Moving services outside of a hospital setting also has advantages to reduce utilization at the higher cost facilities. This includes increasing the use of urgent care, clinics, and ambulatory surgery centers, where appropriate.

Even in geographic markets with adequate competition, provider consolation remains a threat to reducing competition. Some of this consolidation may have positive benefits –the potential to improve the integration of care for example. However, consolidation is more typically viewed as a negative because of its anti-competitive effects. Strategies to address provider consolidation may include using legal avenues such as participating in lawsuits challenging anti-competitive mergers and serving as experts in the review of mergers. Another strategy is to increase our legislative engagement.

Insurer competition

CalPERS has implemented large pieces of the Managed Competition strategy as envisioned by Stanford University emeritus Professor Allan Enthoven.[10] The model, which was fully developed in 1993, is designed to create incentives for members, providers, insurers, and purchasers to achieve better quality of care, reduce costs, and increase member satisfaction. The principles include allowing members options to choose health plans and having insurers compete against each other based on cost rather than benefit design strategies to reduce adverse selection.

While managed competition has resulted in healthy competition in some areas of the state, it has limited effectiveness in others. Specifically, it faces challenges in geographical areas where there are insufficient plan choices, or where more plan participation could undercut insurer negotiations with providers.

To research and address these important issues, CalPERS has engaged Leemore Dafney, Ph.D., from the Harvard Business School on a research study into market competition. She is a national expert on health care competition and will be leading the work to develop a model and provide guidance. Currently, the study is in the development phase, but the goal of the study is to provide data and information to guide CalPERS decisions on maximizing competition. Because this research will provide novel insight into California markets, CalPERS has been able to engage the California Health Care Foundation to financially support part of this effort.

Next Steps

CalPERS team members are conducting various activities to examine pricing variations across markets. This includes work that will allow us to compare the costs of care for specific procedures, episodes, or bundles of care, and to better understand the cost profile of high-cost hospitals and provider groups. This information can lead to direct discussions with hospitals and insurers on how to bring prices down. Covered California currently implements a similar strategy.

The team is also analyzing other options for improving provider competition or for mitigating costs in areas where competition is low. These include using Centers of Excellence for procedures with high variation in cost across regions, increasing the use of telehealth in areas with fewer providers, and moving care to an appropriate level of care for routine services.

The scope of work for the competition study conducted by Dr. Dafney is being developed with the goal to provide insight on how CalPERS can increase competition with its health plan offerings. We expect to receive a report by late summer or early fall.

Budget and Fiscal Impacts

CalPERS cost for its portion of the market competition study is available in the Health program's current operating budget.

Benefits and Risks

A better understanding of market competition in California can provide CalPERS with a variety of options to better contract for health care to reduce premium costs to CalPERS, its employers, and members. The risks include the opportunity lost to lower health care costs by being uninformed as a result of a lack of data and analysis.

Attachment

Attachment 1 - County Cost Relativities Map

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