

Anthem cigna merger block



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US federal court blocks \$48bn Anthem-Cigna merger

Article (<https://www.ft.com/content/56a0e9e2-ee6a-11e6-930f-061b01e23655>)

United States District Court earlier had rejected two of the health insurance industry mergers, including Aetna, Humana, Anthem and Cigna merger. United States Ministry of Justice filed to stop these two acquisitions in July last year. US antitrust officials considered that the acquisition would reduce competitiveness and increase premiums. If these two merger cases approved, major health insurers would reduce from 5 to 3 in the United States. Moreover, Anthem and Cigna will comprise the largest medical insurance group. This essay I will mainly discuss the reasons that U. S's government tend to block the health insurance company merger in the U. S. Although the merger would increase firm profit if the reduce of cost is enough in Cournot model, there is a high opportunity that the merger firm would raise the price in the market. The Anti-competitive behaviour would bring negative effect on the whole health insurance market and consumer might suffer higher premium. The negative impact from an increase of price would even higher in the inelastic demand market. In this essay, I will start with analyse the reasons of merger.

Horizontal merger which mean the merger between firms that compete in the same product market. K. D. Brouthers (1998) argue that the strategic motivation of merger includes increased competitiveness, market power and stable profit growth. The merger firm may benefit from the merger due to reduce cost of production. Moreover, the price could reduce which increase

consumer's surplus. However, horizontal merger can have a negative impact on market competitiveness, anticompetitive effects can be initiated in horizontal merger. Results of horizontal mergers is to directly reduce or even eliminate market competitors.

In the Article, the firms claimed there was an increase of the cost due to an increase amount of the insurance enrolment after the reformation of healthcare system in the U. S. The reason of merger is to reduce the cost which may maintain the efficiency of whole business. The biggest benefit of horizontal consolidation is to achieve economies of scale, thereby reducing the cost of unit products. Stan Laura(2011) claimed that the Synergy effects on horizontal merger, horizontal merger reduce the associated contact costs and transaction costs. Moreover, it expects there will be a higher profit than nonmerger firms. Moreover, Production technologies can be exchanged because of the merger, some unique or patented technology that will be introduce in the technology in the merger firm after it becomes merged. Therefore, Production technology may improve, reduce production costs, or increase product quality (Schumpeter, 1942). The horizontal merger reduces fixed cost and variable cost for merged firm in Cournot model (Farrell and Shapir, 1990). However, the positive effect from the merger to firm is questionable, as Lichtenberg and Siegel (1992) and Maksimovic and Phillips (2001) discussed, they showed there were only little evidence that merger can increase it productivity and the merger paradox is still not resolves from merger firm.

Although there is not a guarantee that cost efficiencies would increase merger firm' profit, Merger as a stackelberg leader may resolve the merger

paradox, which able to lower the price and always more profitable than nonmerger follower firms. Fauli-Oller (2000) presented models that increase of demand lead to increase in cost or change in product quality would increase the opportunity to merger when other firms also tend to merger, consider firm complete in Cournot market competition. He explains that if the first merger occur, other firms would consider to merger due to there are opportunity to increase profit of low-cost firm in sequential mergers model. It can be explaining why there are two horizontal mergers of insurance industry occur sequentially in the U. S, which including Aetna, Humana, Anthem and Cigna.

Why government need to block the merger?

The health insurance system in the United states highly depend on private health industry. Most hospitals and doctor's clinics are private. It is differed from the UK health system(NHS), which the insurance premium covers by government tax revenue and free healthcare service provide from public hospitals. Moreover, the U. S President Barack Obama signed the federal law in 2010, it requires all US citizens to buy health insurance or pay a fine (Elmendorf, Douglas W, 2010). The private healthcare industry and public health insurance project also has been reformed, which there would be including 30 million non-Medicare citizens of the United States into the coverage of health insurance. The government think there is high opportunity that the merger firm would raise the price in the market. The negative impact from an increase of price would even higher in the inelastic demand market.

In such market, if citizen prefer to enrol rather than pay the free for the health insurance, the demand will become more inelastic due to health insurance become a more necessity after the policy had made. The new policy also increase the demand of insurance due to US citizens without Medicare are covered by Medicare coverage after the reformation (Elmendorf, Douglas W, 2010). Moreover, the firm which can monopoly the market have become easier to increase profit by increase its price due to there are an increase trend of the number of health insurance enrolment and the market demand curve nearly horizontal. An increase in price do not have a big impact of the quantity of demand where the demand of the market is inelastic.

One of the biggest motivation of horizontal merger is to increase market share. Moreover, it may also improve the business's ability to control and the degree of concentration within the market (K. D. Brouthers, 1998). There is a potential for a merger to create a monopoly situation in the market. It may enable enterprises to maintain higher profit margin and increase its monopoly power. It can even become a monopolist. The reduction in the number of enterprises, competition between enterprises may become intensified. The large enterprises may be coordinated or joint to avoid a lose-lose in the competition. If business mergers lead to market dominance, companies may abuse market dominance, thereby blocking markets and hampering entrant access the market. The establishment of cartels could limit the product price, Sales, sales area, thus affecting the normal flow of trade. Therefore, the merger could increase market concentration, reduce number of enterprises in the market. However, there is not guarantee that

consumer would benefit from it and merger firm can be more profitable because merger would reduce output and raise the price. Moreover, If the purpose of merger is not merger to monopoly is unlikely to be profitable in Cournot model (L. Pepall, D. Richards & G. Norman , 2014). Therefore, I can assume that the merger firm have a high incentive to monopoly the market in the long run.

As I discussed above. I would argue that the Merger firm have high incentive to increase price to cover its cost and increase its profit easily in an inelastic demand market. The reduction of number of sellers would increase pricing power and the mark-up ratio, Moreover, the new policy creates more people to enrol health insurance in the U. S. In principle, there could be some reductions in cost. In fact, if their costs fall whether those reductions get transformed into lower prices is still questionable, because mark-up would rise. It is not a forgone conclusion that prices would rise if the cost cut enough. There is not guarantee that merger firm would reduce its price in Cournot model (Lichtenberg and Siegel, 1992). if the mergers were not blocked, the firm number would reduce from 5 to 3. It could create very high market contraction of the health insurance business in the United State.

Antitrust Law, or anti-competitive law, is a law that prevents “ anti-competitive behaviours” and “ unfair business practices” in the U. S (U. S department of justice, 2003), with the goal of ensuring fair economic and economic development by enhancing fair competition in the market. The implementation of the Federal Antitrust Act not only saves consumers money, but also prohibits business behaviour from unreasonably depriving consumers of competitive interests, High products and services. If the

consequence of the merger is to raise premiums and that would frustrate the public policy which is intended to encourage people to take insurance, it counteracts the existing public policy which the U. S government do not want to happen. When there is only one or a few companies exist in the market, any entrants that competes with the market will not be threatened, the price may rise to more than the level of competition until the exclusive or oligopoly of the equilibrium price. Production will decline, through the generation of unnecessary losses, and further into the lower social welfare. Anti-competitive behaviour will weaken the efficiency and fairness of the market (Dhall, 2008). The consumers lack a choice, cannot obtain a reasonable quality of service.

To conclude, the literature view horizontal merger may not benefit the society, it cannot ensure that merger would reduce the health insurance premium. The demand of U. S health insurance market is inelastic; thus, any change of the price would lead to huge impact on consumer surplus. US antitrust officials considered that the acquisition would reduce competition in the market and increase premiums which may harm the customer benefit and increase anti-competitive behaviour which is U. S government do not want see. (1527 words)

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