VALUE IN HEALTH 16 (2013) S24–S33

Available online at www.sciencedirect.com

SciVerse ScienceDirect

journal homepage: www.elsevier.com/locate/jval

Assessing the Impact of Privatizing Public Hospitals in Three American States: Implications for Universal Health Coverage

Stefano Villa, PhD, MS[1,2,*], *Nancy Kane, MBA, DBA*[3]

[1]*Department of Management, Catholic University, Rome, Italy;* [2]*Research Center on Health Care Management (CERISMAS), Catholic University, Milan, Italy;* [3]*Department of Health Policy and Management, Harvard School of Public Health, Boston, MA, USA*

ABSTRACT

Many countries with universal health systems have relied primarily on publicly-owned hospitals to provide acute care services to covered populations; however, many policymakers have experimented with expansion of the private sector for what they hope will yield more cost-effective care. The study provides new insight into the effects of hospital privatization in three American states (California, Florida, and Massachusetts) in the period 1994 to 2003, focusing on three aspects: 1) profitability; 2) productivity and efficiency; and 3) benefits to the community (particularly, scope of services offered, price level, and impact on charity care). For each variable analyzed, we compared the 3-year mean values pre- and postconversion. Pre- and postconversion changes in hospitals' performance were then compared with a nonequivalent comparison group of American public hospitals.

The results of our study indicate that following privatization, hospitals increased operating margins, reduced their length of stay, and enjoyed higher occupancy, but at some possible cost to access to care for their communities in terms of higher price markups and loss of beneficial but unprofitable services.

Keywords: privatization, public hospitals, universal coverage.

Introduction

Public hospitals play a vital role in sustaining population access to health services, even in countries with universal health systems. Public ownership, however, is believed to encourage inefficiencies or unresponsiveness to meeting population health needs because of excessive political influence or the lack of traditional private ownership incentives to produce efficient and effective care. Thus, policymakers in many countries have explored or implemented policies that encourage expansion of the private sector provision of health care services even when universal coverage is publicly financed. This article explores key implications of expanding the private sector role to ensure universal access to high-quality and affordable care particularly for vulnerable, low-income populations, in the United States.

In the American health care system, publicly-owned hospitals coexist with private hospitals, both for-profit and nonprofit. While the vast majority of the American hospitals are privately-owned, public hospitals still represent a significant share of the providers and play a unique and extremely valuable role. In particular, they serve as community hospitals for lower-income neighborhoods, they are specialty providers for publicly-funded patients, and they act as "safety-net" providers for the uninsured, with many providing significant amounts of charity care (hospital services offered free of charge or heavily discounted to poor and uninsured people); they disproportionately provide a set of valuable but unprofitable services, such as psychiatric services and trauma care; they provide a critical training ground for medical students, physicians, and other health care professionals; and they are uniquely positioned to carry out research specific to the low-income and indigent populations they serve [1,2].

Given this special role played by American public hospitals in guarantying access to care for the community, it is important to assess whether this role is maintained following privatization. The article empirically analyzes the impact of the privatization of community hospitals that occurred between 1994 and 2003 in three American states (California, Florida, and Massachusetts).

In the developed countries (especially the United States and Europe), privatization has long been a popular policy approach for seeking health care savings or increases in efficiency. Important questions regarding the efficacy of privatization, however, remain unanswered, including the meaning of privatization. The term "privatization" is often used to indicate many different types of public-private relationships such as outsourcing, public-private partnerships, government contracts with private companies, and franchise systems. Also, the concept of privatization is often confused with that of market competition in theorizing about its potential benefits. Many who advocate privatization do so on the grounds that private ownership allows the benefits of market competition; however, privatization does not lead automatically to an increase in the level of competition, and public hospitals can also compete in a marketplace. Donahue [3]

Conflicts of interest: The authors have indicated that they have no conflicts of interest with regard to the content of this article.

* *Address correspondence to:* Stefano Villa, Largo F. Vito n. 1, Rome 00168, Italy.

E-mail: stefano.villa@unicatt.it.

1098-3015/$36.00 – see front matter

http://dx.doi.org/10.1016/j.jval.2012.10.003

provides evidence from a variety of different sectors (e.g., garbage collection, office cleaning, and transportation) that "profit-seeking private firm" is potentially a far superior institution for efficient production, but he also stresses the point that an essential contributing factor is the level of market competition.

In the current article, we will adopt a restrictive concept of privatization referring to all those situations where hospital assets are actually transferred from public to private ownership.

Several theories support the concept that "ownership" matters in performance. One set of theories hypothesizes that public organizations tend to be inefficient because the relationship between the owners (the citizens) and the managers is mediated by politicians who impose objectives on these firms that might help them to gain votes (e.g., by favoring union's collective bargaining power, or by seeking patronage appointments for their supporters) but often conflict with efficiency [4–6].

A second hypothesis, derived from stakeholder theory, posits that public organizations are required to maximize the utility/well-being of all involved constituencies in society [5,7,8]. The compelling mandate to mediate among conflicting constituencies makes it more difficult for publicly-owned organizations to set shared performance goals and, consequently, to implement effective incentive schemes [7–9] that would promote efficiency.

Others note that the goals of hospitals vary by ownership type. In simple microeconomic models, for-profit hospitals are modeled to maximize profit. Private nonprofit hospitals must balance multiple objectives such as profits, quality, quantity, and charity care [10–12]. Public hospitals, while considered inefficient [13], are often required to be the provider of "last resort" for people who cannot pay for medical care or health insurance. One big question, then, in assessing the impact of conversion is how this unique public hospital mission—provider of last resort—is affected by privatization.

The American hospital sector is characterized by a high number of conversions (change of ownership). Particularly, during the period of our analysis, public hospital privatizations represented the most common form of conversion: 296 public hospital conversions (56% of the total) in the period 1980 to 1991 and 289 in the period 1991 to 2001 (more than 40% of all conversions) [14,15].

Public hospital conversions to private ownership in the United States offer a unique opportunity to explore the effects of hospital privatization. Most hospital ownership and conversion research has focused on conversions of nonprofit private hospital to investor-owned status or are cross-sectional studies on the differences in behavior among the different types of hospital ownership. The lack of research on public hospital privatization leaves an important gap in our understanding of the implications for communities.

Also, even though the American health care system is different from many other systems in the developed world (in its reliance on competitive markets, multiple public and private payers, and the active purchasing role played by employers and consumers), the results of the current study can offer useful insights to those policymakers outside the United States who are striving to maintain universal coverage systems guaranteeing high quality standards while seeking, at the same time, a reduction in overall costs. This article empirically tests whether private providers are actually better than public providers in accomplishing this goal. In fact, in the last 25 years, European countries have implemented a series of reforms intended to either change the public-private provider ownership mix, such as privatization or closure of public hospitals, and reducing the scope of public coverage or care provision, or to encourage public hospitals to become competitive with private sector hospitals, by introducing competitive elements in health care financing and/or provision [16]. In these reforms, policymakers implicitly assume that privatization and/or increased competition represent an effective solution to maintain the sustainability of their universal health coverage (UHC) systems overcoming typical problems plaguing public providers such as inappropriate political influence, lack of responsiveness to patient needs, waste, and poor clinical quality.

The current article aims to test these assumptions through a longitudinal study that analyzes the impact of privatization on different dimensions: efficiency, profitability, and benefits to the community.

Literature Review

Despite the growing importance of privatization on the agenda of policymakers, there are relatively few empirical studies that analyze the actual results of ownership change. Many simply focus on ownership in a static sense. A meta-review [17] of 153 cross-sectional studies shows superiority in terms of efficiency of private ownership compared with public, finding 104 studies in favor, 14 against, and 35 neutral.

Cross-sectional studies are, however, unlikely to provide a robust measure of the impact of converting from one ownership type to another, or how long it might take to see related changes in performance. Cuervo and Villalonga [5] propose a model where privatization is a discrete exogenous change that triggers a series of endogenous changes. According to this model, privatization leads to 1) a change in corporate governance and 2) management replacement. This, in turn, leads to a change in goals, incentives, and control that, subsequently, brings a change in strategy, structure, and culture. This model is intuitively plausible, but untested in real settings, and it is also important to take into account other contextual factors such as regulation, the level of competition, and the method of privatization.

With respect to the analysis of changes in hospital performance related to conversion, most of the articles to date focused on nonprofit to for-profit conversions [14,18–20]. Studies that have addressed the impact of public to private conversion have mixed results, depending on the performance metric analyzed. Some authors [21–24] have focused their attention on the provision of uncompensated care. The item "uncompensated care" is determined by the sum of 1) charity care and 2) bad debt. Bad debt refers to unpaid bills of patients considered by hospital management to be capable of paying their bills. Some of these studies [21,22] are cross-sectional studies comparing the characteristics (location, number of beds, uncompensated care) of privatized public hospitals with those of nonconverting public hospitals: privatized public hospitals had fewer beds and provided less uncompensated care relative to nonconverting public hospitals. Other studies [23,24] have, on the contrary, tried to assess the actual impact of privatization on uncompensated care; the results are mixed: uncompensated care declined when public hospitals converted to for-profit status, but no clear-cut results emerged when public hospitals converted to not-for-profit status.

Regarding efficiency, one study [25] found that costs were not reduced by public hospital conversions; rather, public hospital conversion to for-profit ownership was associated with a slight increase in cost per admission. In contrast, an older study [26] found that costs were reduced under the private management, but the service mix changed: particularly unprofitable services such as emergency services and psychiatric care were dropped. Shen [27] who analyzed hospital conversions occurring between 1987 and 1998 found that conversions to private ownership (nonprofit and for-profit) increased the probability of trauma center closures. These findings were consistent with the results of other more recent studies [18,28]. Piotrowsky [28] reported that privatized hospitals cut unprofitable outpatient services. Horwitz [18] performed a cross-sectional statistical analysis to see