

# Market Power and Quality: Congestion and Spatial Competition in the Dialysis Industry

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## **Abstract**

I find that dialysis providers in the United States exercise market power by reducing the clinical quality, or dose, of dialysis treatment. This market power stems from two sources. The first is a spatial dimension—patients face high travel costs and traveling farther for quality is undesirable. The second source is congestion—technological constraints may require dialysis capacity to be rationed among patients. Both of these sources of market power should be considered when developing policies aimed at improving quality or access in this industry. To this end, I develop and estimate an entry game with quality competition where providers choose both capacity and quality. Increasing the Medicare reimbursement rate for dialysis or subsidizing entry result in increased entry and improved quality for patients. However, these policies are extremely costly because providers are able to capture 84 to 97 percent of the additional surplus, leaving very little pass-through to consumers. Policies targeting the sources of market power provide a cost effective way of improving quality by enhancing competition and forcing providers to give up producer surplus. For example, I find that a program subsidizing patient travel costs \$373 million, increases consumer surplus by \$440 million, and reduces the mortality rate by 3 percent.