

Antitrust Treatment of Nonprofits

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ABSTRACT

Nonprofit institutions are required to provide socially beneficial activities in exchange for an exemption from taxation. There is a tension between the favored treatment of nonprofits under the tax code and their treatment under the antitrust laws if those laws do not recognize the reason for the favored treatment. For example, nonprofit hospitals are expected to treat indigent patients without full compensation. Providing uncompensated care will result in negative profits, so this requires that hospitals have other, non-indigent customers that are profitable. Funding indigent care in this way is commonly referred to as cross-subsidization. Hospitals operating in highly competitive markets will have little ability to price discriminate, limiting in turn their ability to cross-subsidize the provision of services to the indigent. An important implication is that, to the extent that nonprofit hospitals do in fact provide more care to the poor in the face of less competition, the antitrust laws, which are designed to promote competition, may contradict the policy rationale for granting tax exemptions to nonprofits.

If the premise that nonprofit hospitals provide more care to the poor as they face less competition is true, then the inconsistency between competition and the benefits of nonprofit status suggests that the courts should give consideration to the nonprofit status of hospitals in antitrust cases. Hospitals are only a case in point and the result, if true, would likely generalize to other industries in which nonprofit institutions price discriminate in order to benefit otherwise disfavored groups.

We note that this consideration is difficult for courts to quantify and that funding services for the poor via cross-subsidization entails deadweight loss, so a better policy would be direct subsidy to the indigent in a world where antitrust unequivocally protects competition. In the absence of sufficient direct subsidies, favorable or more lenient antitrust treatment of nonprofits may improve welfare relative to uniform antitrust enforcement.

The key underpinning of the argument for favorable antitrust treatment of nonprofits is that where nonprofits have the power to elevate price to some consumers, the resulting profits are used to provide services to other consumers, such as the poor. Other possibilities, such as opportunistic behavior by nonprofit administrators, the dissipation of rents through non-price competition, and other forms of regulatory evasion, exist. If any of these factors loom large, granting favorable treatment to nonprofits may result in deadweight loss and lost tax revenue without the benefits that form the rationale for the nonprofit tax exemption.

To empirically evaluate this question, we analyze 2001-2007 panel data on pricing, competition, and charity care provision by for-profit and nonprofit hospitals in California to determine (1) whether nonprofit hospitals that face less competition provide more charity care and (2) whether areas that are less competitive overall have higher levels of charity care.