Health Plan Choice and Competition

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Introduction

- In a world with universal health insurance for the U.S. Markets can be expected to play important roles in
  - Purchase of health plans
  - Selection of providers
  - Choice of treatment
- Behavioral economics points to circumstances where consumers and physicians make decisions that run counter to economic notions of rationality
- Economists often view such claims skeptically believing that errors of significance do not persist--markets adjust to correct errors in the longer term
- My remarks focus on health plan markets where I believe markets and policy do and do not appear to adjust to correct errors, respectively

Consumer Choice

- Standard view of consumer choice faces challenges in health care
- Health Care Choices often involve
  - Numerous Choices
  - Complex choices—multiple attributes
  - High stakes circumstance—health and money
- Research points to status quo bias; choice overload; limited ability to process information; and mistake aversion in health care decisions
- All of these inhibit making effective or any choice

Evidence

- Choice Overload
  - Frank and Lamiraud show that switching rates fall with number of choice (relative odd 0.65 after 55 choices) even in the presence of substantial price dispersion (20-30%)
  - Elbel and Schlesinger show that probability of joining Medicare Part C increases in markets with up to four plan choices and then declines
- Status Quo Bias
  - Samuelson and Zeckauser observe incumbents less likely to purchase new plans compared with matched set of new enrollees
  - Strombom, Buchmueller and Feldstein find price elasticities for health plans significantly higher for new employees, all else equal
  - Hibbard et al show elderly frequently shy away from making insurance choices
- Mistake Aversion
  - Financial Services take-up
  - Hold on to stocks and health insurance too long

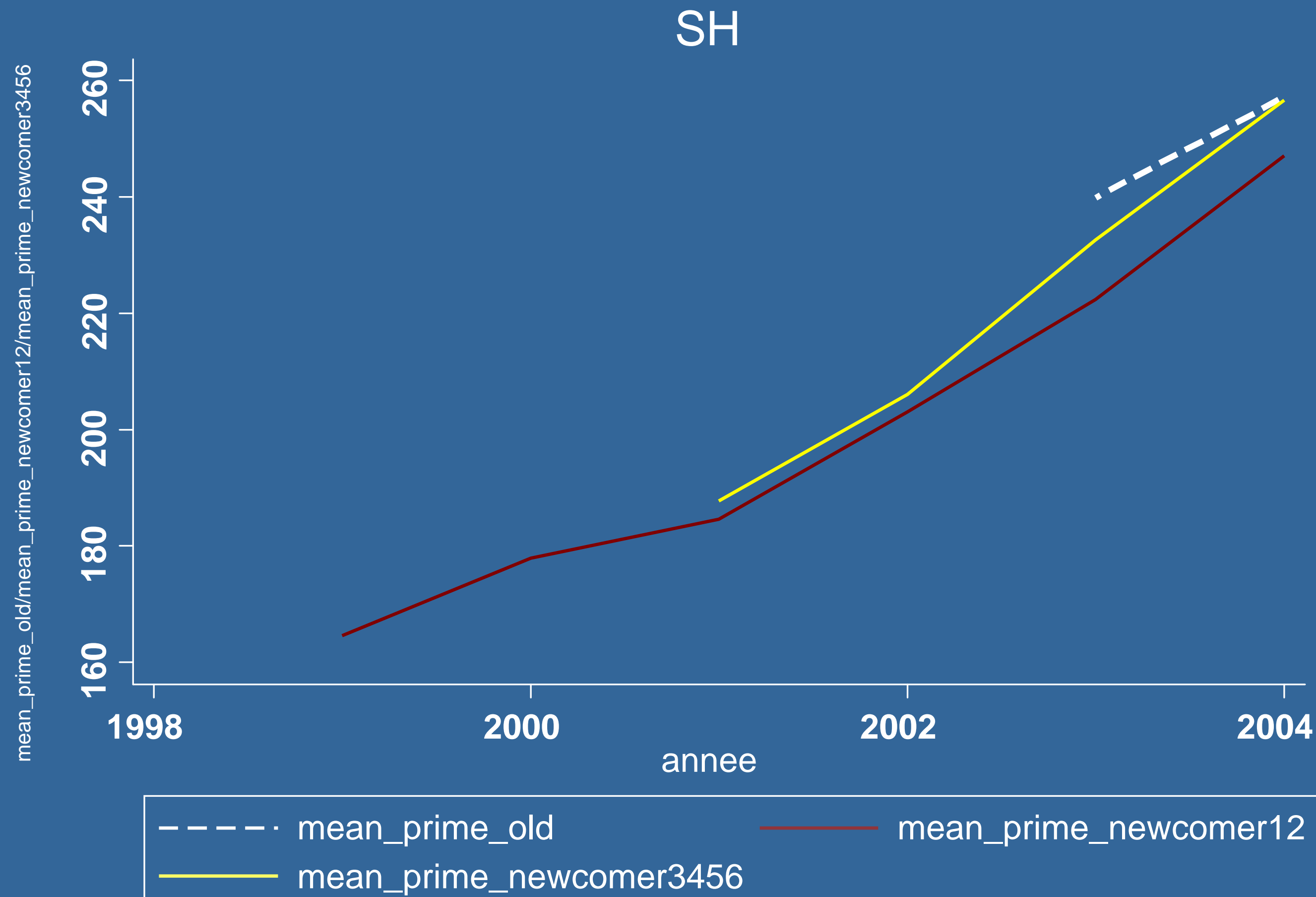
Equilibrium

- In markets that display frictions from choice overload and status quo bias firms face less elastic demand wrt price and quality
- Profit maximizing strategy set initial prices low (at entry or at program initiation) to attract enrollees and then raise prices since demand response falls after enrollment

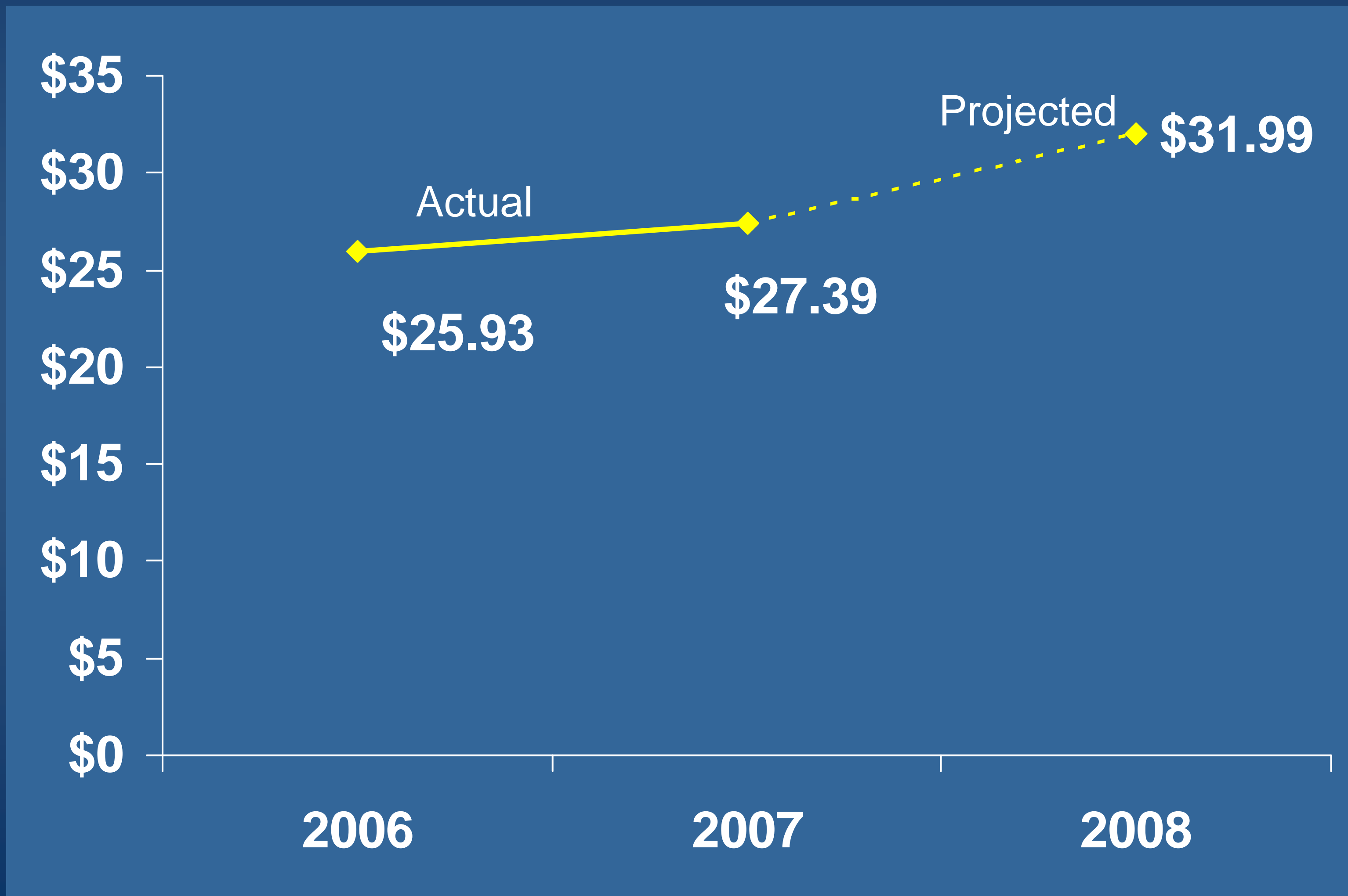
Evidence

- Switzerland
  - Premiums increase with number of firms
  - Premiums increase with firm's time in market
  - New entrants have lower premiums
- Medicare Part D
  - Low PDP switching rates in second year
    - 3.1 million Part D enrollees switched to PDPs (12%)
    - Of the 3.1 million switchers 2.1 million were involuntarily reassigned
    - Overall 4-6% switched
  - Price increases average about 17%

Premium Level by Plan Vintage



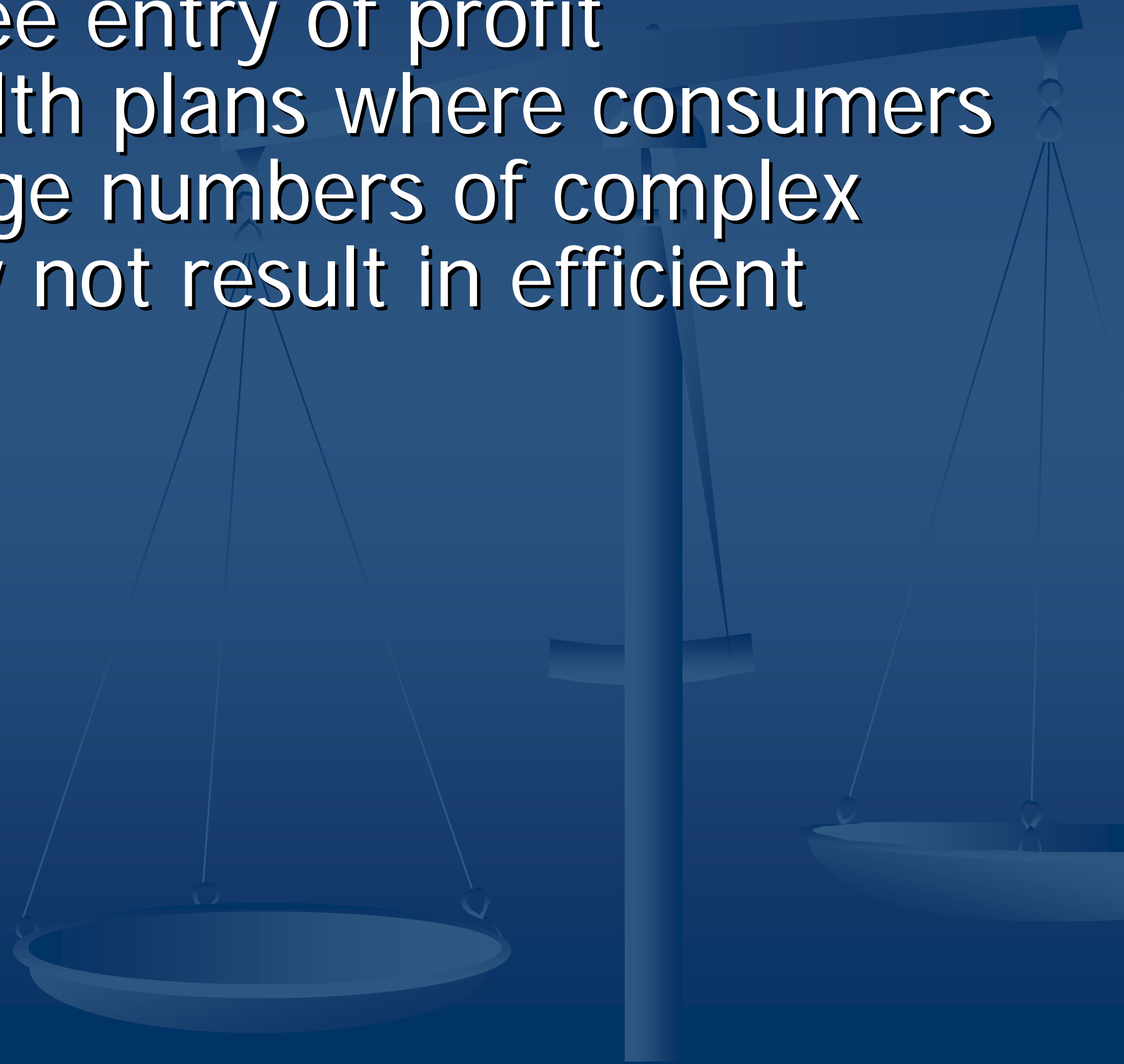
Weighed Average Monthly PDP Premiums, 2006-2008



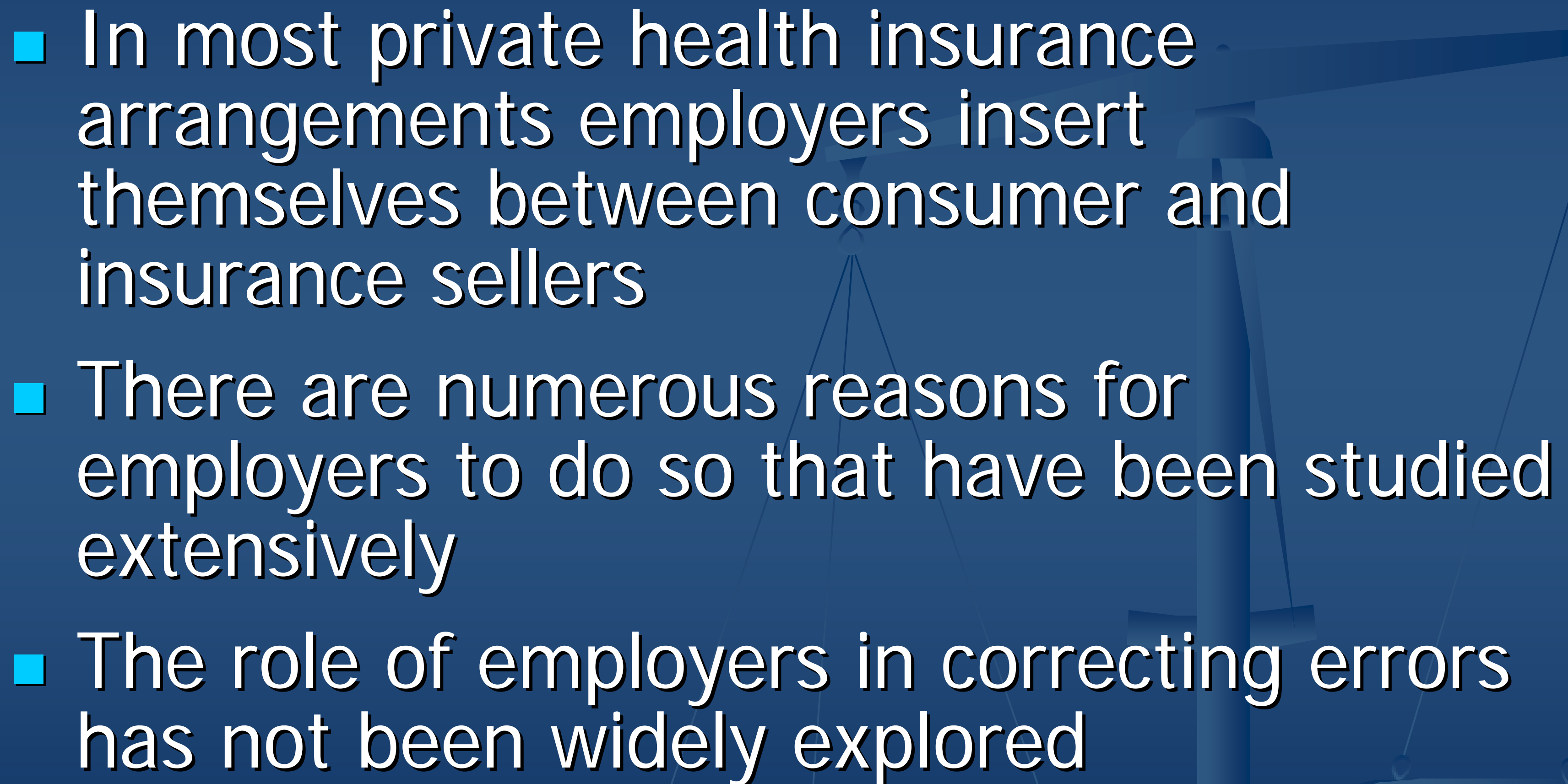
Source: *Hoadley et al analysis of CMS PDP landscape files, 2006-2008, for the Kaiser Family Foundation*

Observation

- Markets with free entry of profit maximizing health plans where consumers directly face large numbers of complex choice will likely not result in efficient equilibrium



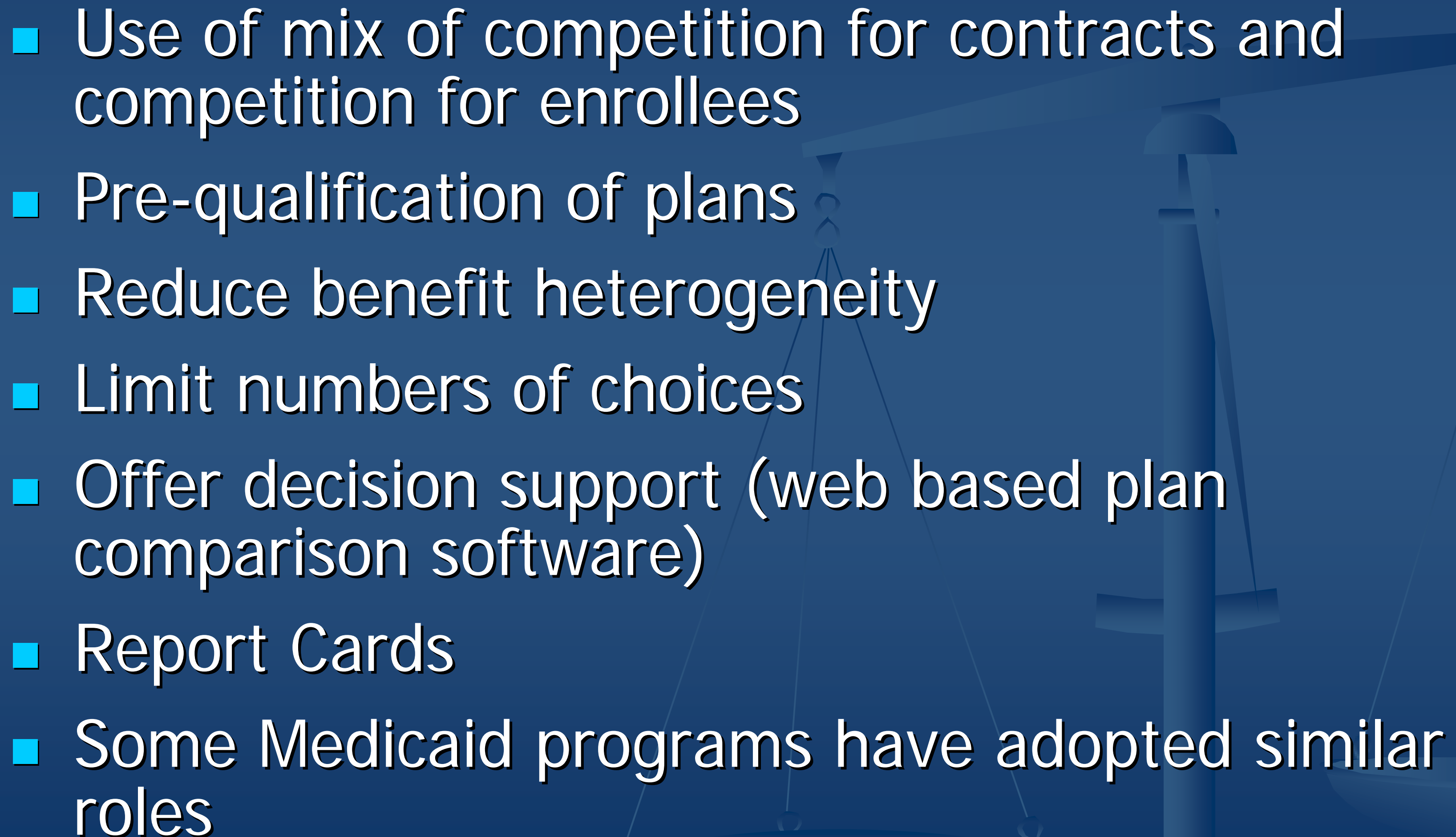
Private Solution



- In most private health insurance arrangements employers insert themselves between consumer and insurance sellers
- There are numerous reasons for employers to do so that have been studied extensively
- The role of employers in correcting errors has not been widely explored

What Employers Do?

- Use of mix of competition for contracts and competition for enrollees
- Pre-qualification of plans
- Reduce benefit heterogeneity
- Limit numbers of choices
- Offer decision support (web based plan comparison software)
- Report Cards
- Some Medicaid programs have adopted similar roles



Policy Implications

- A central choice in the design of health insurance markets involves to what extent consumers face the market directly
  - Medicare Parts C and D represent the most direct relations
  - AWP philosophy
  - Broad diversity of offerings
  - Some decision support
- The employer sponsored health insurance market—offers an active intermediary
- FEHBP sits somewhere in between

Policy II

- Switzerland's experience represents a case where there is universal coverage and direct consumer—insurance interaction
- The resulting equilibrium is troubling
- If one is convinced by the evidence on errors in consumer behavior in health insurance markets then having more active intermediaries can promote a type of competition that may offer more efficient equilibriums in price and quality