Why Does Health Insurance Cost So Much?

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Overview

- What contributes to the cost of insurance?
- Health care costs and insurer margin
- Pooling and risk selection
- Impact of more uninsured on risk selection, margin, and average cost
- Options for addressing rising premiums
What Explains the Cost of Insurance?

- **Health care costs**
  - Use and price of care
  - Pooling and risk selection

- **Financing costs: insurer margin**
  - Administrative cost
  - Insurer surplus
Components of Private Insurance Cost
U.S., 1998-2002

Source: CMS National Health Expenditure Accounts.
Pooling and Risk Selection

- Most cost is associated with relatively few covered lives: 20% account for 80% of cost
- The lowest-cost people are least likely to buy insurance when it is voluntary
- Adverse risk selection raises the average cost of insurance for those who buy it
Distribution of Total Cost: Employer-Sponsored Health Insurance, U.S.

Calculated from Blumberg et al., Inquiry (forthcoming).
Risk Selection Among Insurers

- In every state, insurance markets are concentrated:
  - 1 to 3 insurers hold at least half of the market
  - On average, 3 insurers hold 2/3 of the market

- Risk selection among insurers is less likely with fewer insurers—but it can happen

- Premiums are as high as the worst risk pool, if smaller insurers shadow price
What Happens When Coverage Falls?

- More uncompensated & avoidable care
- More adverse selection
- More insurer surplus for risk

Higher average premiums
Increase in Margin as a Percent of Premium Growth

Source: CMS National Health Expenditure Accounts.
Margin as a Percent of Cost: Private Insurers and Public Programs, U.S. 1997-2002

Source: CMS National Health Expenditure Accounts.
Holding the Line on Insurance Premiums

- Address health care costs
- Stabilize and expand coverage to reduce risk selection system-wide
- Look for risk selection among insurers
  - Risk adjustment pool
  - Reinsurance pool
- Watch insurer margins
  - Comprehensive rate filing and review
  - Minimum loss ratio, small-group and individual coverage
What About More Insurers Competing?

- Insurance markets are naturally concentrated
  - Economies of scale in insurance, so fewer insured people = fewer insurers
- ...and they tend to stay concentrated
  - New entrants are small and may not grow, or enter by buying smaller insurers
- Managing a concentrated market
What About Consumer-Driven Plans and Health Savings Accounts?

- Less insurance = smarter care?
- Distribution of medical costs suggests little impact on total cost
- Education & incentives for improved health? Case and disease management?
- More uncompensated care in the system?
Old Rules Still Hold

- Smarter, more efficient health care is essential
- More uninsured and less access to care tend to make insurance more costly
- Health care and health insurance markets are unlikely ever to be really competitive, so watch pricing