



Affordable Health Insurance for high-risks: an impossible task?

Conference

“Developing Pro-Poor Health Insurance in India”

New Delhi, 01nov06

Wynand P.M.M. van de Ven
Department of Health Policy and Management
Erasmus University Rotterdam



Competitive insurance market

As the start-up of health insurance in most countries takes place in an unregulated competitive market, the focus will be on:
“affordable health insurance for high-risks in a free *competitive* market”.



Agenda

1. A free competitive insurance market;
2. Taxonomy of premium subsidies;
3. Analytical framework for organizing cross-subsidies in a competitive insurance market;
4. Lessons from experience in practice.



Free competitive market

- In a free competitive market insurers have to break even, in expectation, on each contract either by adjusting the premium to the consumer's risk (*risk-adjusted premiums*) or by adjusting the accepted risk to the premium (*risk selection*).
- The premium differences can easily go up to a factor 100.



No long term insurance

- In a free competitive market the premium for an insured who develops AIDS, cancer or heart disease has to be raised in the next contract period. Or the insurer may not renew the contract.
- In such a market voluntary health insurance can *only* provide protection against *unpredictable* variation of costs *in the contract period* (usually a year).



Relevant for Micro Health Insurance?

- Is the market for micro health insurance competitive? Is there any consumer choice of micro health insurance unit?
- Do the low-risks have the option to leave the micro health insurance unit and buy risk-rated insurance?
- Experience in Europe learns that over time local micro health insurance units become national competitive macro insurers.



Affordable health insurance

Which strategies, in addition to Social Re, can be used in a competitive health insurance market to make health insurance affordable for high-risk individuals?

Two strategies to do so:

1. explicit premium subsidies;
2. implicit premium subsidies.

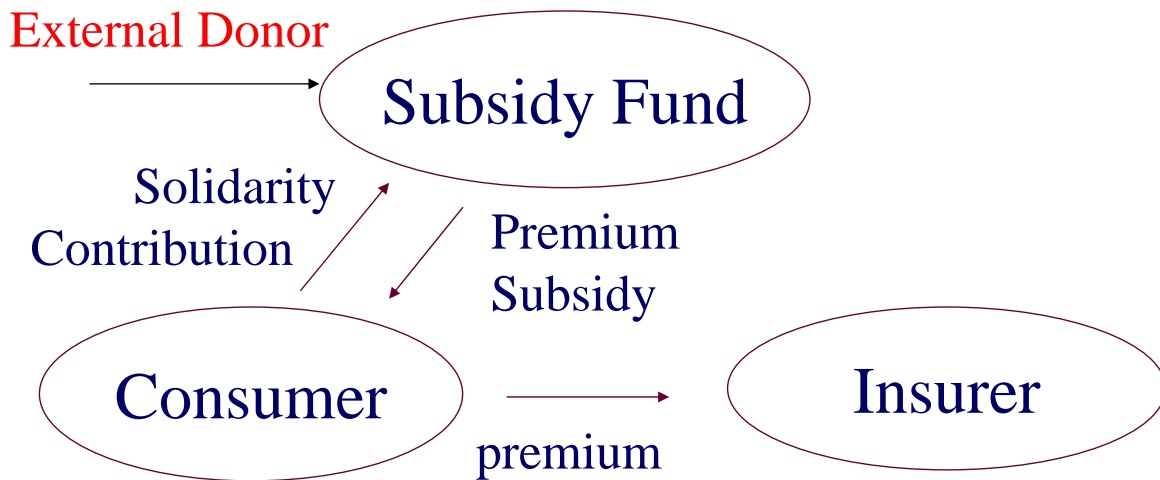


Explicit premium subsidies

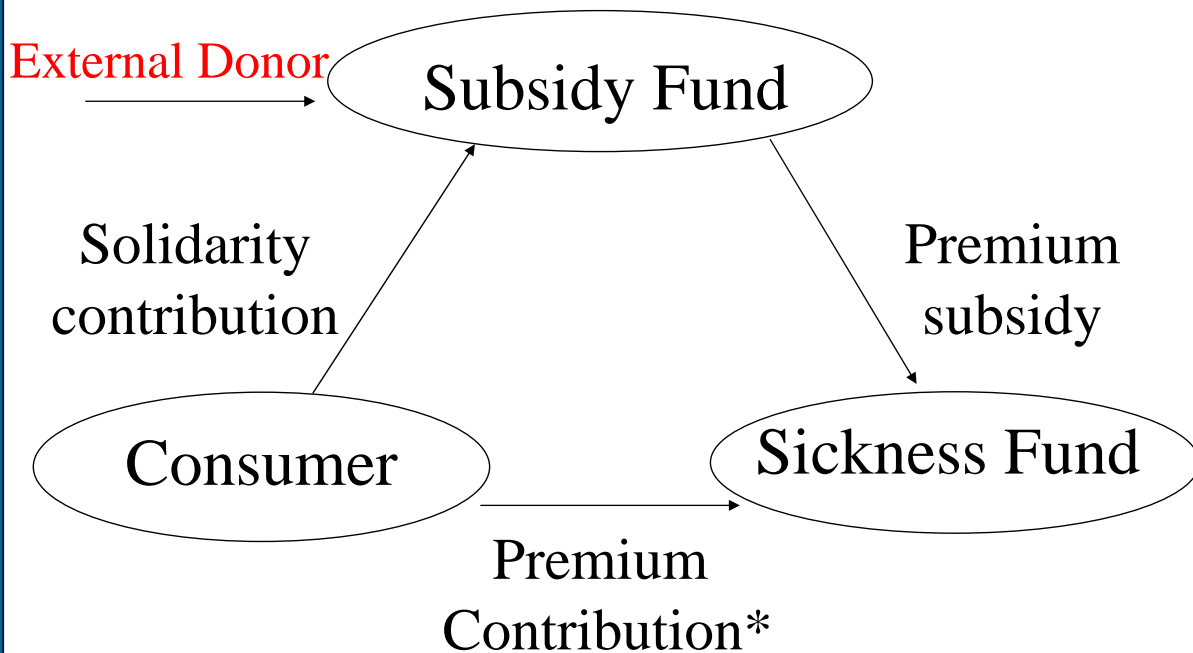
- Insurers are free to set risk-adjusted premiums;
- High-risk persons receive a premium subsidy from a Subsidy Fund, which is filled by external donors and/or mandatory contributions;
- High risks pay their premium partly with the subsidy and partly out of pocket.



Premium subsidies



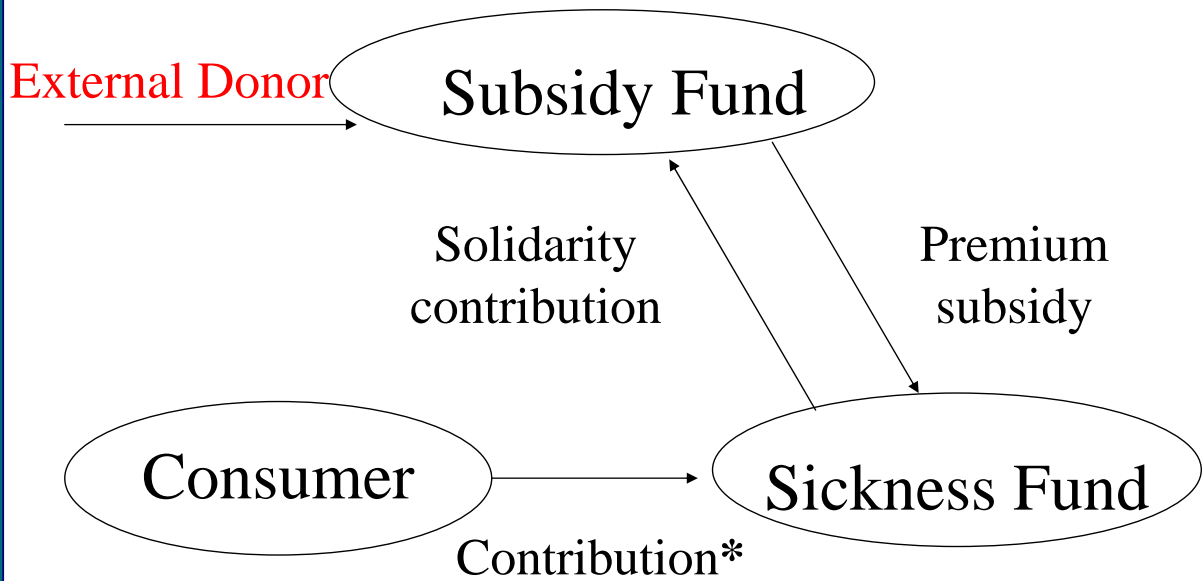
Risk Equalization



*premium contribution = premium minus premium subsidy



Risk Equalization



*Contribution = solidarity contribution plus premium contribution



Implicit premium subsidies

An alternative is regulation: premium rate restrictions and open enrolment. The goal is to create *implicit* cross-subsidies from the low-risks to the high-risks.

However, such pooling of people with different risks creates substantial incentives for risk selection, which may threaten affordability, efficiency, quality of care and consumer satisfaction.





Preferred strategy

- Politicians may prefer premium rate restrictions and open enrolment.
- To prevent regulation-induced selection, risk-equalization (i.e. risk-adjusted premium subsidies) is needed.
- Because this eliminates the need for premium rate restrictions, the *explicit* premium subsidy approach is the preferred strategy.



Types of premium subsidies

- Premium-adjusted subsidies;
- Risk-adjusted subsidies.

(the subsidies can be means-tested)



Premium-adjusted subsidies

Premium-adjusted subsidies are not optimal:

1. Less effective price-competition because
 - a. they reduce the incentive for high-risk consumers to shop around for the lowest premium;
 - b. consequently they reduce the insurers' incentive for efficiency.
2. They induce over-insurance resulting in additional moral hazard.



Risk-adjusted subsidies

An effective way to deal with these problems is to have *risk-adjusted* subsidies rather than premium-adjusted subsidies.

Risk-adjusted premium subsidies are based on the risk factors that insurers use, such as age and health status, and do not distort competition.



Experiences in practice

- A free insurance market tends to risk-adjusted premiums and risk selection;
- Sooner or later such markets are characterized by government regulation to achieve affordability;
- In nearly all settings: open enrollment and premium rate restrictions;
- In all settings with risk-bearing insurers:
→ risk selection problems.



Risk equalization is essential

In the last decade an increasing number of countries aim at reducing selection by the implementation of risk equalization.

Risk equalization is an essential precondition for reaping the benefits of a competitive health insurance market. Otherwise the disadvantages of a competitive health insurance market may outweigh its advantages.



In practice: very complex!

In practice, however, risk-equalization appears to be very complex. Although at least 15 countries have implemented a system of risk equalization in the last decade, no country has yet a sufficiently good system.



Lesson

In a *competitive* health insurance market it is very complex to make health insurance premiums affordable for high-risk individuals without reducing the incentives for efficiency. Many high-income countries are in the process of implementing an adequate risk equalization system, but so far no country has sufficiently succeeded.



Lesson

Countries that want to implement a health insurance system with premiums that are affordable for high-risk individuals, are advised to seriously weigh the advantages and disadvantages of having a competitive health insurance market versus a non-competitive market.



(non-)competitive insurance market ?

The major advantage of a non-competitive health insurance market is that there is no selection, no need for risk rating, lower transaction costs, and better options for the coordination of local health care delivery.

The Achilles' heel of a monopolistic market is that the insurers have no incentive for efficiency, for reducing moral hazard and for being responsive to the consumers' preferences.



Relevant for Micro Health Insurance?

- Is the market for micro health insurance competitive? Is there any consumer choice of micro health insurance unit?
- Do the low-risks have the option to leave the micro health insurance unit and buy risk-rated insurance?
- Experience in Europe learns that over time local micro health insurance units become national competitive macro insurers.