

# Why Does Health Insurance Cost So Much?

**Deborah Chollet**

Senior Fellow, Mathematica Policy Research

Hawaii Institute for Public Affairs and  
Hawaii Uninsured Project 2004 Health Policy Forum

Honolulu, Hawaii  
October 13, 2004

---

**MATHEMATICA**  
Policy Research, Inc.

---

# Overview

---

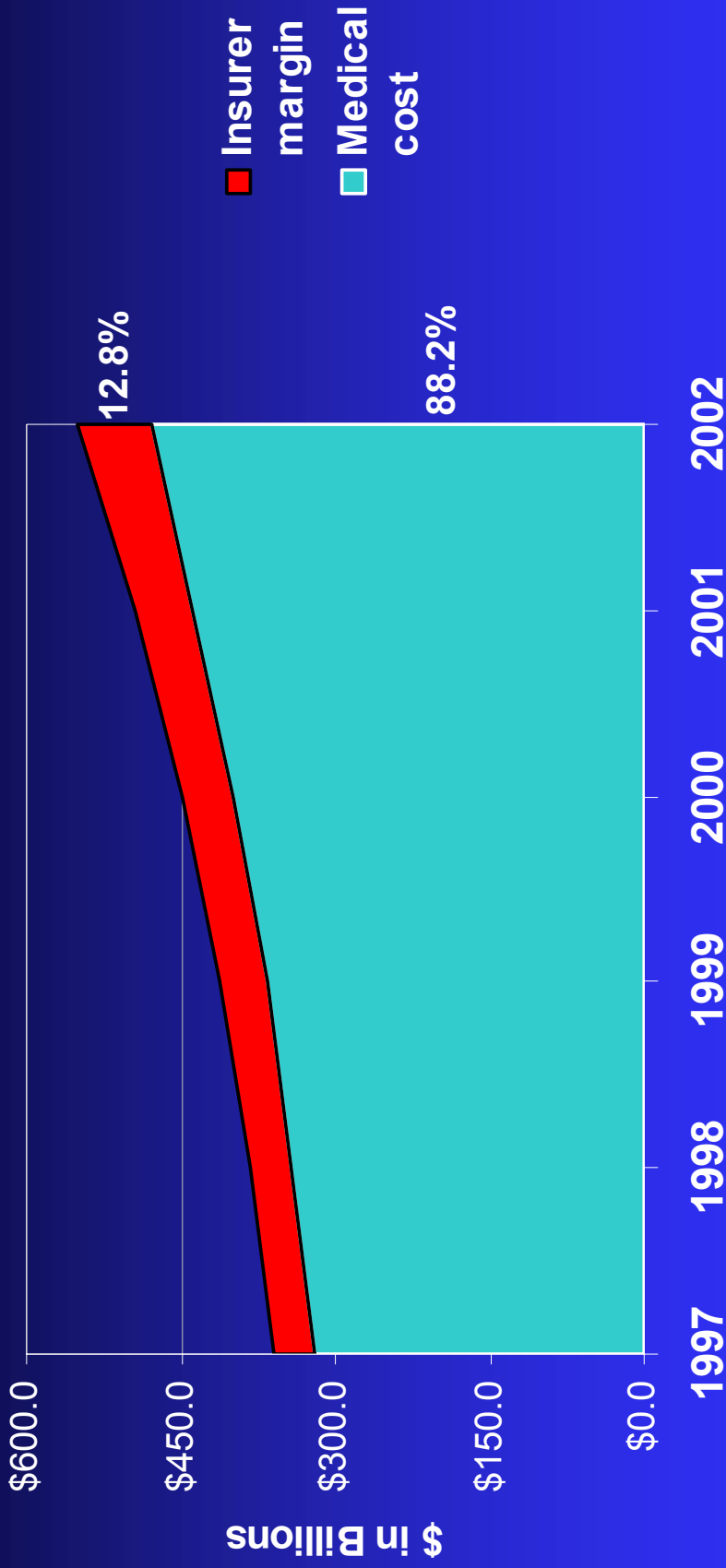
- What contributes to the cost of insurance?
- Health care costs and insurer margin
- Pooling and risk selection
- Impact of more uninsured on risk selection, margin, and average cost
- Options for addressing rising premiums

# 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



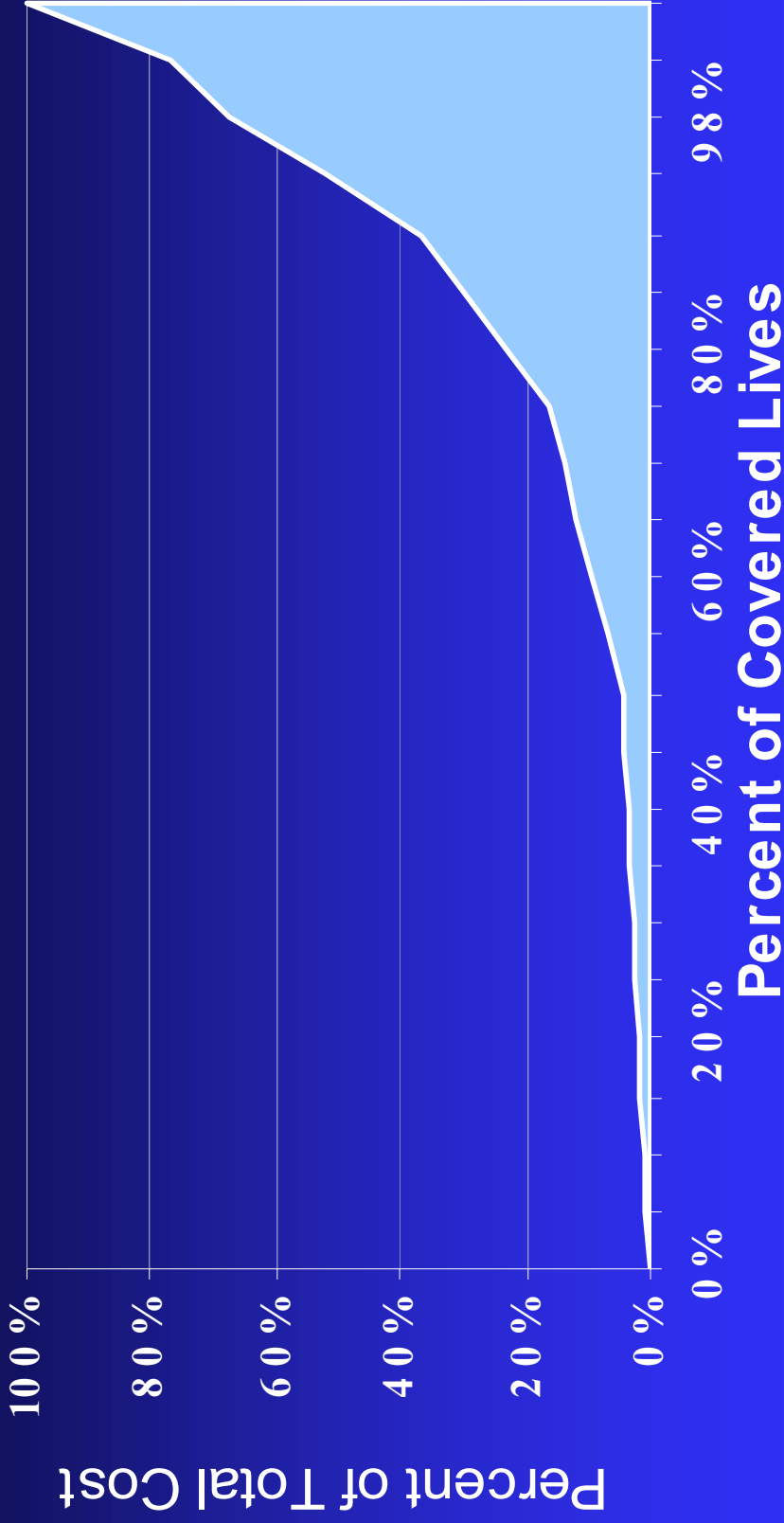
Source: CMS National Health Expenditure Accounts.

# 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.



Source: 1998-2000 MEPS data, covered persons under age 65.  
Calculated from Blumberg et al., Inquiry (forthcoming).

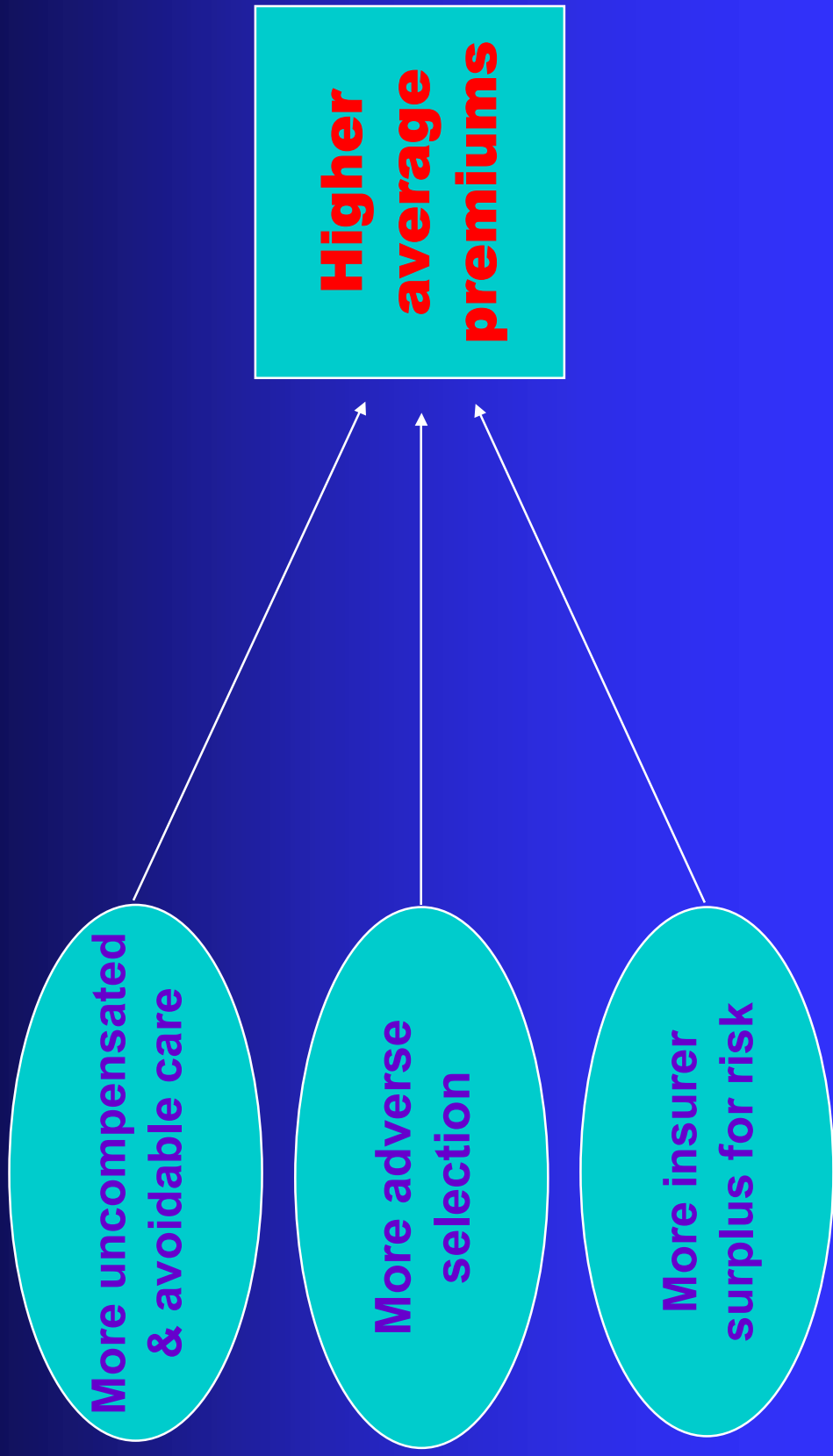
# Risk Selection Among Insurers

---

- **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?

---

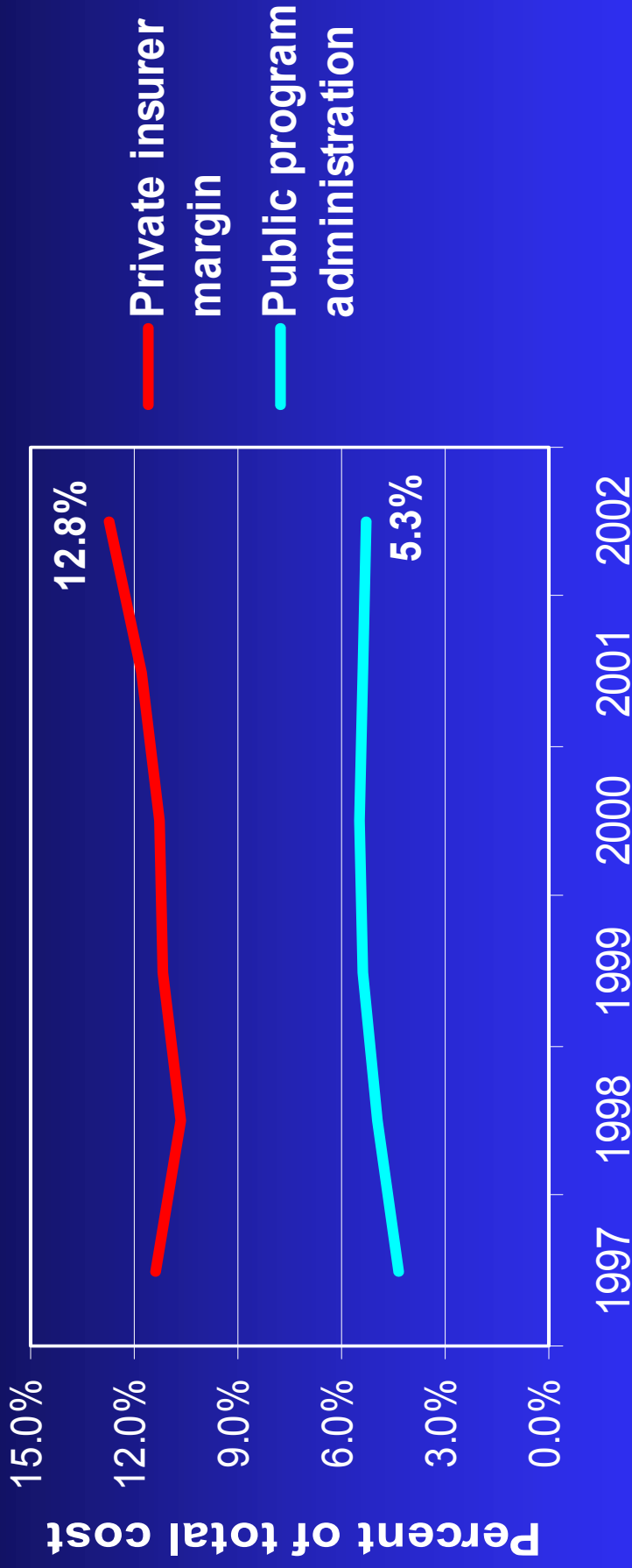


# Increase in Margin as a Percent of Premium Growth Private Insurance & Public Programs, U.S. 1998-2002



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