ELSEVIER

Journal of Health Economics 19 (2000) 311–339

JOURNAL OF HEALTH ECONOMICS

www.elsevier.nl/locate/econbase

Access to coverage for high-risks in a competitive individual health insurance market: via premium rate restrictions or risk-adjusted premium subsidies?

Wynand P.M.M. van de Ven *, René C.J.A. van Vliet, Frederik T. Schut, Erik M. van Barneveld

Institute for Health Policy and Management, Erasmus University Rotterdam, P.O. Box 1738, 3000 DR Rotterdam, Netherlands

Received 13 October 1997; received in revised form 26 July 1999; accepted 27 August 1999

Abstract

A competitive market for individual health insurance tends to risk-adjusted premiums. Premium rate restrictions are often considered a tool to increase access to coverage for high-risk individuals in such a market. However, such regulation induces selection which may have several adverse effects. As an alternative approach we consider risk-adjusted premium subsidies. Empirical results of simulated premium models and subsidy formulae are presented. It is shown that sufficiently adjusted subsidies eliminate the need for premium rate restrictions and consequently avoid their adverse effects. Therefore, the subsidy approach is the preferred strategy to increase access to coverage for high-risk individuals. © 2000 Elsevier Science B.V. All rights reserved.

JEL classification: I10; I11; I18; G22
Keywords: Access; Health insurance; Regulation; Selection; Subsidies; Risk-adjustment

* Corresponding author. Tel.: +31-10-408-85-25; fax: +31-10-408-90-94; e-mail: vandeven@bmg.eur.nl

PII: S0167-6296(99)00028-4

1. Introduction

A major problem of an unregulated competitive market for individual health insurance is the seeming incompatibility of the equivalence principle and the solidarity (or fairness) principle. The *equivalence* principle of a competitive insurance market implies that an insurer has to break even on each insurance contract. The *solidarity* principle, as the Europeans term it, implies that the high-risk individuals receive a subsidy from the low-risk individuals to increase their access to health insurance coverage. [1] This situation would occur if each insurer would accept predictable losses on the contracts of the high-risk individuals and compensate these losses by predictable profits on the contracts of the low-risk individuals. However, in a competitive market such a system of cross-subsidies cannot be sustained because competition minimizes the predictable profits per contract. Consequently, an insurer has to break even on each contract either by adjusting the premium to the consumer's risk (premium differentiation) or by adjusting the accepted risks to the premium (selective underwriting). So, in a unregulated competitive market the premium for an insured consumer who develops AIDS, cancer or a heart disease has to be raised in the next contract period (usually a year) to the expected cost level or, alternatively, the insurer may decide to exclude from coverage the costs related to medical conditions which pre-exist before the new contract period, or not to renew the contract at all. For automobile, burglary and fire insurance these consequences of the equivalence principle appear to be socially acceptable. For health insurance this is not the case. In most countries a sponsor (e.g., government or employers) takes actions to increase access to health insurance coverage for the high-risk individuals. Often these actions result in a reduction of the level of competition in the individual health insurance market, e.g., a monopolistic national health insurance or an employer offering to its employees options from only one risk-bearing insurer. Since a restriction of competition may reduce efficiency, an increasing number of countries are looking for ways to combine competition and universal access. Therefore, this article addresses the question: *how can a sponsor make the solidarity principle compatible with the equivalence principle in a competitive individual health insurance market*?

A straightforward way is that the sponsor imposes restrictions on the variation of the premium rates for a specified health insurance coverage, possibly combined

[1] In this paper we restrict the concept of solidarity to so-called ''risk-solidarity'', that is solidarity between low- and high-risk individuals. Solidarity between high- and low-income individuals, so-called ''income-solidarity'', will not be considered here. Conceptually ''income-solidarity'' can be easily incorporated in a system with ''risk-solidarity'' (see Section 3.1).