The effect of report cards on consumer choice in the health insurance market

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Abstract

We test the effect of report cards on consumer choice in the HMO market. Federal employees were provided with report cards on a limited basis in 1995 and then on a widespread basis in 1996. Exploiting this natural experiment, we find that subjective measures of quality and coverage influence plan choices, after controlling for plan premiums, expected out of pocket expenses and service coverages. The effect is stronger within a small sample of new hires compared to a larger sample of existing federal employees. We also find evidence that report cards increase the price elasticity of demand for health insurance.

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1. Introduction

Report cards help consumers make better-informed choices among the products and services they consume. In the case of health insurance, report cards seek to translate complex data about plan benefits and treatments into a small number of dimensions that are understandable and useful to consumers.1 Effective report cards expand the consumer’s information set and enable them to select plans that offer the best tradeoff between quality

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1 Perhaps the best-known example of a health plan report card is the health plan employer data and information set survey (HEDIS). Consumer reports has also published health plan report cards.
and cost. The effect of report cards on consumer decision-making depends on the information consumers have about health insurance plans in the absence of report cards and on report cards conveying meaningful additional information to consumers. The purpose of this paper is to test the hypothesis that consumer report cards influence the consumer’s choice of health plan.

In this paper we provide an empirical test of the joint hypothesis that report cards provide relevant information to consumers and that consumers are less than fully informed in their absence. Our evidence is based on the plan selections of a sample of new and existing US federal employees in the years 1995 and 1996. Federal employees select their health insurance under a program called the federal employees health benefits plan (FEHBP), which provides them with multiple plan choices. Starting in 1995, the FEHBP’s administrative arm, the Office of Personnel Management (OPM), began to compile report cards on each included plan, although these were not widely distributed. The following year, 1996, the report cards were also widely distributed. We are able to use the natural experiment created by OPM to test the joint hypothesis.

Our tests are based on analyses of plan choice in 1995 and 1996. The 1995 choice regressions establish a baseline of consumer information with respect to financial and quality dimensions, prior to the widespread introduction of report cards. Re-estimation of the choice regressions using 1996 data is used to assess the net impact of report cards on consumer choice. We focus on the differences in key coefficients for plan quality and coverage between 1995 and 1996 in order to measure the impact of report cards on consumer-decision making.

Our results contribute to the emerging literature that considers the role of health plan report cards in consumer-decision making (Edgman-Levitan and Cleary, 1996; Hibbard and Jewett, 1996, 1997; Sainfort and Booske, 1996; Tumlinson et al., 1997; Chernew and Scanlon, 1998; Spranca et al., 2000; Beaulieu, 2002; Farley et al., 2002; Harris et al., 2002; Scanlon et al., 2002). Early work in this area concentrated on hypothetical questions about the kinds on information consumers would find useful. More recent work has focused on the effect that distributing health plan report cards to consumers has on plan choice. Our work provides additional evidence on this important question.

Our results also bear on the more widely researched price elasticity of demand for health insurance. It is possible that in the absence of report cards consumers will use prices to partially infer plan quality, thus reducing the price elasticity of demand. This is consistent with an argument made by Royalty and Solomon (1999), who argue that vigorous price competition between plans can only occur where consumers are confident that plans have comparable quality and coverage. Our results test the proposition that report cards makes choices more responsive to price.

The paper is organized as follows. In Section 2, we review the prior work in the area of health plan choice and health plan report cards. In Section 3, we discuss the natural experiment that resulted from OPM’s policies. Data and methods are given in Section 4.

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2 The FEHBP dates back to 1959 when the government first instituted health benefits for federal employees. Under the FEHBP, federal employees select their health insurance from a number of insurers in their local market. Insurers are included in the choice set provided that they have contracts with the government. The government pays 71% of the plan premium, regardless of the plan selected.
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