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Managed competition and consumer price sensitivity in social health insurance

Frederik T. Schut [a,*], Wolter H.J. Hassink [b]

[a] *Department of Health Policy and Management (iBMG), Erasmus University Rotterdam, P.O. Box 1738, 3000 DR Rotterdam, The Netherlands*

[b] *Economics Institute, Utrecht University, Utrecht, The Netherlands*

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Abstract

This paper examines whether the introduction of managed competition in Dutch social health insurance has resulted in effective price competition among insurance funds. We find evidence of limited price competition, which may be caused by low consumer price sensitivity. Using aggregate panel data from all insurance funds over the period 1996–1998, estimated premium elasticities of market share are −0.3 for compulsory coverage and −0.8 for supplementary coverage. These elasticities are much smaller than in managed competition settings in US group insurance. This may be explained by differences in switching experience and higher search costs associated with individual insurance.

JEL classification: D12; G22; I11; I18

Keywords: Health plan choice; Managed competition; Premium elasticities; Social health insurance; Switching costs

1. Introduction

In an increasing number of industrialized countries, governments are considering the use of market forces in social health insurance as a strategy to increase efficiency and consumer choice. Traditionally, social health insurance programs have been designed to guarantee financial access. Participation was mandatory and revenues collected centrally and allocated to non-competing administrative bodies. However, the increasing cost of social

* Corresponding author. Tel.: +31-10-4088558; fax: +31-10-4089094.
E-mail address: schut@bmg.eur.nl (F.T. Schut).

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health insurance programs and the lack of efficiency incentives place governments under increasing pressure to reform these programs.

The model of managed competition (Enthoven, 1978, 1988) combines universal financial access with competition and incentives for efficiency. Although the model is elegant in theory, and notwithstanding attempts in several countries to introduce managed competition into their health care systems, nowhere has the model been fully implemented. Empirical evidence of the model's efficacy is thus limited. In the US, the employee health insurance program of Wisconsin (Hill and Wolfe, 1997), the Federal Employees Health Benefits Program (Feldman et al., 1999) and the health benefits programs of such large universities as the University of California and Harvard and Stanford Universities (Buchmueller and Feldstein, 1997; Cutler and Reber, 1998; Royalty and Solomon, 1999) incorporate several features of the managed competition model. However, none of these programs have risk-adjusted premium contributions, a crucial element of the managed competition model.

Recent reforms of the Dutch social health insurance system have been strongly influenced by the model of managed competition. In 1988, the Dutch government adopted the Dekker Plan, which aimed at the introduction of a national health insurance scheme with managed competition. The Dekker Plan has much in common with the abandoned Clinton Plan in the US (Health Security Act 1994) but unlike Clinton's Plan, the Dekker Plan has been implemented. Nevertheless, its initial ambitious goals to reform all existing health insurance schemes (including private health insurance and long-term care insurance) were duely modified to a less comprehensive reform of the mandatory social health insurance scheme covering about two-thirds of the Dutch population. After years of political debate and preparatory measures, the actual implementation of managed competition reforms began in 1992, although it took until 1996 before social health insurance funds (or sickness funds) were allowed to compete on price. Key features of the reforms are the transition from retrospective to risk-adjusted prospective payments to sickness funds, the introduction of flat-rate out-of-pocket premiums and freedom of choice for subscribers. Sickness funds were allowed to engage in selective contracting and in managing care, but have not to date done so. One reason for this is that the supply and price of health services is still heavily regulated by government. Hence, the Dutch social health insurance system is in a transitional phase, moving from supply-side regulation towards managed competition.

In this paper we empirically analyze the response of sickness funds and their enrollees to the introduction of managed competition. The period studied is the initial stage of managed competition in which sickness funds could primarily compete on price. We investigate whether sickness funds compete on price, whether price competition is effective in restraining profits and how the prevailing price variation may be explained. A crucial precondition of effective price competition is that consumers are inclined to search for lower-priced substitutes. We therefore examine the sensitivity of consumers to premium differences. We have used a set of panel data gathered from all 25 Dutch sickness funds over the period 1996–1999. We then compare consumer price sensitivity in the Dutch social health insurance sector with that in managed competition settings in US employment-based group insurance. We conclude that price elasticities in US managed competition settings are substantially higher than in the Dutch reformed social health insurance setting. Likely explanations are differences in search costs and switching experience. Search costs appear to be lower in group insurance than in individual insurance because the employer facilitates consumer