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The Effect of Competition in the Health Insurance Market

In general, extant research suggests that increased competition in the health insurance market eventually leads to lower premium rates, but only when a substantial number of competing companies enter a given market. The number of companies it will take to noticeably decrease premiums depends upon the size of the market. Additionally, competition between insurers may lead to variations in insurance rates between high-risk and low-risk consumers.

Leading academics have consistently quoted an article in the *Journal of Health Economics* by Wholey, Feldman, and Christianson, as the preeminent research examining competition and health care premiums. In a January 29, 2004 email, Harvard School of Public Health Professor Nancy Turnbull directed us to Dr. Roger Feldman of the University of Minnesota, as “one of the leading experts on health care competition.” In a February 2, 2004 email, Meredith Rosenthal, Assistant Professor of Health Economics and Policy at Harvard University concurred, saying that this is “the only paper I know of on this topic.”

The Wholey, et al. study, released in *The Journal of Health Economics* in May of 1995 examined the effects of Health Management Organization (HMO) market structure on the costs of health insurance premiums. According to Wholey et al., “A central, but empirically unsupported, tenet of managed competition proposals is that the establishment of more HMOs will create competitive pressure on premiums, resulting in lower premium levels. This paper uses data on HMO premiums from 1988-1991 to test the hypothesis that the expansion of HMOs has resulted in lower premiums for health care consumers.”

In an e-mail response on February 2, 2004, Roger Feldman (one of the co-authors of the *Journal of Health Economics* study), who served on Ronald Reagan’s Council of Economic Advisors summarized his research by saying, “[t]he short answer is [that] competition has a measurable effect on reducing health insurance premiums.”

Wholey, et al., ascertained that “more competition, measured by the number of HMOs in the market area, reduces HMO premiums. Although this effect does not appear for an Independent Practice Association (IPA) before the highest level of competition is reached, it appears throughout the competitive range for Group HMOs. More market penetration (measured by the percent of the market area population enrolled in HMOs) reduces premiums for IPAs.” According to the study, premiums only begin to decrease once the highest level of competition is

reached. At the highest level of HMO market penetration, the maximum reduction in premium costs is 8%. "These results support the hypothesis that HMO penetration interacts with the number of HMOs operating in a market to reduce IPA premiums." The authors suggest that a threshold number of HMOs must be present for lower premiums to be observed. "This downward pressure on premiums then causes HMOs to attempt to reduce expenditures for services purchased from their contracting providers. Thus, in theory, competition in the insurance market leads to lower premiums for insurance, lower payments to providers and more efficient use of medical care resources." (Wholey, et al.) While these results show positive effects of increased competition, the following research takes additional factors into consideration.

In an internal research memorandum for the CPB Netherlands Bureau for Economic Policy, researcher Rudy Douven examined health care market structure and the effects of community ratings on insurance premiums in the Netherlands. In his conclusion, Douven stated "The efficient delivery of medical services may be pursued by intensifying competition among health care insurers... increasing competition may foster efficiency-raising activities, reduce insurer profits and lower health care costs. However, it may also increase the variability of consumer premiums and increase risk-type specific selection activities by insurers as the government will generally lack information on the risk characteristics of the insured."

In an e-mail to Art Woolf (Professor of Economics at The University of Vermont, former State Economist for Vermont Governor Madeleine Kunin, and current editor of *The Vermont Economy Newsletter*), the question was posed "does the presence of more (or fewer) insurance companies in a market like Vermont have any measurable effect on health care costs and/or the cost of health insurance?" Woolf responded by e-mail on January 29, 2004, stating "The simplest answer is that competition in every other market, including the market for insurance for homes, life, and auto, works that way, so why shouldn't that be true for health insurance? One problem is that Vermont is very small so it's harder to make competition work, but that's not insurmountable."

Resources

Douven, Rudy "Regulated Competition in Health Insurance Markets" *CPB Netherlands Bureau for Economic Policy*, November, 2000. <http://www.cpb.nl/eng/pub/onderzoek/171/om171.pdf>

Wholey, D., R. Feldman, and J. B. Christianson. 1995. "The Effect of Market Structure on HMO Premiums." *Journal of Health Economics* 14 (1): 81-105.

The Agency for Healthcare Research and Quality
<http://www.ahcpr.gov/news/press/pr2002/insprepr.htm>

This report was prepared at the request of Vermont Senator Gerry Gossens and Representative Daryl Pillsbury by J. W. Dunnivant, Selene M. Hofer-Shall, and Rebecca McCarty, February 9, 2004 under the supervision of Professor Anthony Gierzynski.