Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

Special Series: Health Reform Issues

January 27, 2010

MAJOR INSURANCE MARKET REFORMS WILL NOT WORK UNLESS THEY ARE PART OF BROADER HEALTH REFORM

By January Angeles, Sarah Lueck, Edwin Park, and Judith Solomon

Insurance market reforms are a key element of the comprehensive health reform bills that the House and the Senate have passed. Under the bills, insurers in both the individual and small-group insurance markets would be barred from denying coverage to people with pre-existing conditions, charging higher premiums based on a person's health status or gender, or placing annual or lifetime caps on covered benefits.

In recent days, some policymakers have suggested that Congress should consider forgoing comprehensive legislation and enacting instead a scaled-back bill that focuses primarily on these popular health insurance market reforms. As President Obama, Nobel prize-winning economist Paul Krugman, and other analysts and commentators have pointed out, however, this approach will not work; it could disrupt existing insurance markets and cause health insurance premiums to spike. (See the box on page 2.)

These market reforms will work properly only if they are enacted as part of broader health reform legislation that includes, among other things, both a requirement for individuals to have health insurance and provisions to make health insurance affordable for people of modest means. These elements are included in the comprehensive health bills that the House and Senate have passed.

Enacting Market Reforms in Isolation Would Drive Up Premiums and Raise Rather than Lower Health Insurance Costs

Instituting new requirements for private insurers to cover anyone who applies for a policy (known as "guaranteed issue") and prohibiting insurers from charging higher premiums based on health status as well as other factors (known as "community rating") are long overdue and necessary improvements to health insurance markets. But if instituted in isolation, these reforms would tend to *drive up* premiums and thus make health care coverage *less,* not *more,* affordable.

That is because the people most likely to enroll in health coverage after enactment of such reforms would disproportionately be older people and people with pre-existing medical conditions, who previously had been unable to purchase insurance and are the ones most urgently in need of

President Obama, Paul Krugman, Steven Pearlstein, and Eugene Robinson Agree: Insurance Market Reforms Won't Work in Isolation

"If you ask the American people about health care, one of the things that drives them crazy is insurance companies denying people coverage because of preexisting conditions. Well, it turns out that if you don't . . . make sure that everybody has health insurance, then you can't . . . stop insurance companies from discriminating against people because of preexisting conditions. Well, if you're going to give everybody health insurance, you've got to make sure it's affordable. So it turns out that a lot of these things are interconnected."

— President Obama, interview with George Stephanopoulos, January 20, 2010

"…. Reform won't work unless all the essential pieces are in place.

"Suppose, for example, that Congress took the advice of those who want to ban insurance discrimination on the basis of medical history, and stopped there. What would happen next? The answer, as any health care economist will tell you, is that if Congress didn't simultaneously require that healthy people buy insurance, there would be a 'death spiral': healthier Americans would choose not to buy insurance, leading to high premiums for those who remain, driving out more people, and so on.

"And if Congress tried to avoid the death spiral by requiring that healthy Americans buy insurance, it would have to offer financial aid to lower-income families to make that insurance affordable — aid at least as generous as that in the Senate bill. There just isn't any way to do reform on a smaller scale."

— Paul Krugman, *New York Times*, January 22, 2010

"One reasonable-sounding idea is that the president should reduce it down to just a few of its most popular provisions. …

"The problem with that, of course, is that if you don't require everyone to buy insurance, then there will be lots of people who will wait to buy their policies until they get sick and then demand coverage at the 'community' rate. That's a great way to drive up premiums, which in turn will drive even more healthy people to drop coverage, which will raise premiums even further.

"To prevent this kind of debilitating 'insurance spiral,' you could add one more feature —- a mandate requiring everyone to buy at least a basic insurance package. Unfortunately, there are lots of low-income households for which the newly mandated premiums could eat up as much as a half of after-tax income, which hardly seems fair."

— Steven Pearlstein, *Washington Post*, January 22, 2010

"One thing that people agree on is prohibiting the insurance companies from denying coverage on the basis of preexisting conditions. But doing that in isolation would cause insurance premiums to skyrocket. To make it work, you need a mandate that forces everyone — including millions of young, healthy people — to buy insurance, thus effectively subsidizing the older, sicker people whom the insurance companies would be forced to cover. But if you make low-income and moderate-income people buy health insurance, you have to give them financial assistance because otherwise they can't afford it."

— Eugene Robinson, *Washington Post*, January 22, 2010

health care. This effect, called "adverse selection," would drive up premiums significantly since less healthy people cost more to treat — and thus to insure. The resulting increase in premiums could discourage *healthy* uninsured people from buying coverage and lead some individuals in better-than-average health who currently have coverage to decide to forgo it.[1] This, in turn, would raise premiums still higher.

Adverse selection is always a significant risk in a voluntary system like we have today, in which healthier people can opt to remain uninsured. For example, several states have recently attempted to expand coverage to the uninsured by setting up their own health plans. Unlike Massachusetts, however, these states have *not* required that individuals have coverage. As one would expect, early experience with these plans has shown that older and sicker people are the ones most likely to enroll.

In Indiana, for example, the Healthy Indiana Plan (HIP) enrolled 35,000 previously uninsured people, a take-up rate of *only 5 to 10 percent* of eligible uninsured individuals in Indiana. An actuarial analysis determined that these enrollees used more health care and were more likely to be in poorer health than those typically enrolled in commercial health insurance plans.[2] Similarly, in the first year of operation of Connecticut's Charter Oak Plan, the percentage of people enrolling who were older was greater than expected. As a result, the state is raising premiums for the plan in February 2010.[3]

In the absence of comprehensive reform, efforts by states to create voluntary health insurance exchanges to help *small businesses* purchase insurance also often have suffered from adverse selection. The small businesses most likely to enroll were those with older or sicker workers. Most such initiatives consequently have failed.[4]

In contrast, under the House and Senate bills, healthy as well as less-healthy individuals would enroll, due to the combination of the individual insurance mandate and subsidies to make insurance affordable.

An Individual Mandate Is Needed to Avoid Adverse Selection and Increase Coverage

Requiring individuals to have insurance or pay a penalty, as the House- and Senate-passed health reform bills do, would help avert the premium increases that would be likely to occur if insurance market reforms are enacted in isolation. It would discourage healthier people from going without coverage until they get sick and thereby cause the people signing up for coverage to represent a more typical mix of healthy and less-healthy individuals. This would result in better-functioning risk pools and keep premium costs in check. It would also substantially increase the overall number of people with health coverage.[5]

---

[1] See, for example, Linda Blumberg and John Holahan, "Do Individual Mandates Matter?," Urban Institute, January 2008.

[2] Rob Damier "Experience under the Healthy Indiana Plan: The short-term cost challenges of expanding coverage to the uninsured," Milliman, August 2009.

[3] Minutes of Connecticut Medicaid Managed Care Council, January 8, 2010.

[4] See, for example, Mark Merlis, "A Health Insurance Exchange: Prototypes and Design Issues," National Health Policy Forum, Issue Brief No. 832, June 5, 2009; Elliot Wicks, "Building a National Health Insurance Exchange: Lessons from California," California Health Foundation, July 2009; and Elliot Wicks, "Health Insurance Purchasing Cooperatives," The Commonwealth Fund, November 2002.

[5] Jonathan Gruber, Len M. Nichols, and Mark V. Pauly, "Health Debate Reality Check: The Role of Individual Requirements," New America Foundation, December 6, 2007.

In the current voluntary system, insurers often compete on the basis of enrolling healthier people and discouraging enrollment by those in poorer health, rather than on the basis of which plans perform best on price and on the quality of the coverage they provide. As Urban Institute researchers Linda J. Blumberg and John Holahan note, requiring everyone to have health insurance would render "indefensible" many of the troubling practices that insurers use today, such as denying coverage to people with health problems or charging them higher premiums. Insurers would no longer be able to claim these practices are essential to avoid adverse selection.

A requirement for individuals to have insurance also would help improve market incentives for insurers. With greater assurance of a well-balanced risk pool, they would be able to focus on managing costs and improving the quality of care, rather than on devoting extensive resources to "cherry-picking" the healthy and deterring or denying the less healthy. They also would be more likely to participate in new areas of the country, making insurance markets more competitive in those areas than they would be if insurers continued to assume that people seeking coverage will be disproportionately in poorer-than-average health.[6]

Low- and Moderate-Income People Need Assistance to Make Coverage Affordable

An individual mandate, of course, will not work without assistance to make coverage sufficiently affordable for people of modest means. In 2009, the premium for a typical employer plan, which is less expensive than a comparable policy sold in the individual market, averaged $13,375 per year for a family policy.[7] This represents more than a quarter of the pre-tax income of a family of four earning $50,000 a year.

Low- and moderate-income individuals and families, who make up the bulk of the uninsured, often struggle already to pay for basic items such as food, housing, and utilities. A requirement to purchase health coverage without adequate subsidies could cause these households' budgets to unravel. A 2005 Urban Institute study found that only about 20 percent of uninsured people could afford to purchase insurance coverage on their own.[8]

Conclusion

Robust health insurance market reforms are badly needed and constitute a key element of health reform. Passage of these types of insurance reforms *in isolation,* however, would not constitute effective reform. It would drive up the cost of coverage and cause insurance premiums to rise, with the result that fewer people would be able to afford insurance and some healthy people who now have coverage would likely decide it made more sense to go without it.

For insurance market reforms to be successful, they must be enacted as part of comprehensive health reform that includes an individual mandate and provisions to make health insurance affordable. These are the key elements of the House and Senate bills.

---

[6] Linda J. Blumberg and John Holahan, "The Individual Mandate — An Affordable and Fair Approach to Achieving Universal Coverage," *New England Journal of Medicine*, July 2, 2009.

[7] Kaiser Family Foundation and Health Research Educational Trust, "Employer Health Benefits 2009 Annual Survey," September 2009.

[8] See Lisa Dubay, John Holahan, and Allison Cook, "The Uninsured and the Affordability of Health Insurance Coverage," *Health Affairs* (web exclusive), November 10, 2006.