

Economic Issues in Analyzing Competitive Effects in Health Insurance Markets

NATIONAL ECONOMIC
RESEARCH ASSOCIATES

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Consulting Economists

Overview

- § **1. What is harm to competition?**
- § **2. What are the conditions that keep health insurance markets competitive?**
- § **3. What are the measures and methods that can help us evaluate harm to competition? And are they useful in identifying changes in competitive conditions?**

Harm to Competition

- § **Competition has been harmed when the process of competition has been distorted in a way that leads to:**
 - § **Prices rising above competitive levels or quality falling below competitive levels for a sustained period of time**

- § **Merger analysis: Will the forces that are driving competition prior to a merger remain and therefore continue to drive competition after the merger?**

What Keeps Health Insurance Markets Competitive?

- § **Health insurance can be provided in a number of alternative ways...by insurers and employers**
 - § **The functions of a health insurer include**
 - § the underwriting of risk
 - § the development of a provider network
 - § utilization management
 - § the provision of claims processing and other administrative services

What Keeps Health Insurance Markets Competitive?

§ Ease of expansion

- § Capacity constraints do not have much meaning for health plans
- § For an existing health plan, the incremental cost of expanding capacity is relatively small
- § Similarly, there is no limit to the number of customer contracts that a carrier can enter into
- § The regulatory hurdles are minor in most cases

What Keeps Health Insurance Markets Competitive?

- § **Employers are informed and sophisticated buyers**
- § **Brokers, agents, and consultants play an important role**
 - § By helping employers choose the solution that best fits the company's needs at the right price
 - § By giving companies advice on designing a health benefits plan
 - § By developing requests for proposals and
 - § By selecting the winners, thereby facilitating competition

What Keeps Health Insurance Markets Competitive?

- § **Competition takes place in bidding contests**
 - § **For larger firms, it is a more formal process that can involve surveys and formal requests for proposals**
 - § **Smaller firms can rely on brokers and bids may be formal or informal**

What Keeps Health Insurance Markets Competitive?

- § **Willingness of individual consumers to switch health plans based on price**
 - § **Competition for employees is intense**
 - § **The empirical evidence suggests that consumers are highly sensitive to price**
 - § **This puts a great deal of pressure on health plans to price their products at competitive levels**
 - § **The high degree of consumer price sensitivity is likely to lead to a great deal of “churn”**

What Keeps Health Insurance Markets Competitive?

- § **Employers have bargaining leverage**
 - § **Employers have some buyer power because most people get their health benefits through their employer**
 - § **Competition tends to be fierce when there are large amounts of business at stake**
 - § **Employers can dictate the nature and terms of competition among the health plans**

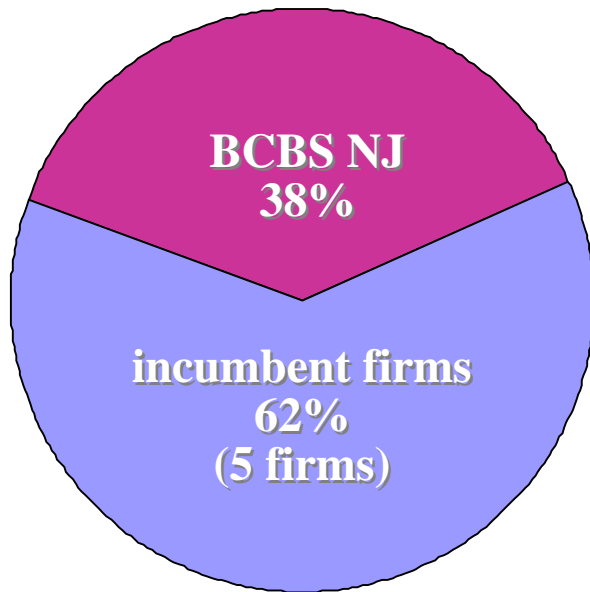
What Keeps Health Insurance Markets Competitive?

- § **Entry is effective as a source of competition**
 - § **Consumers are generally willing to switch health plans**
 - § **In a bidding environment, a new carrier can get a lot of business quickly**

Atlantic City/Cape May New Jersey January 1994 to December 1998

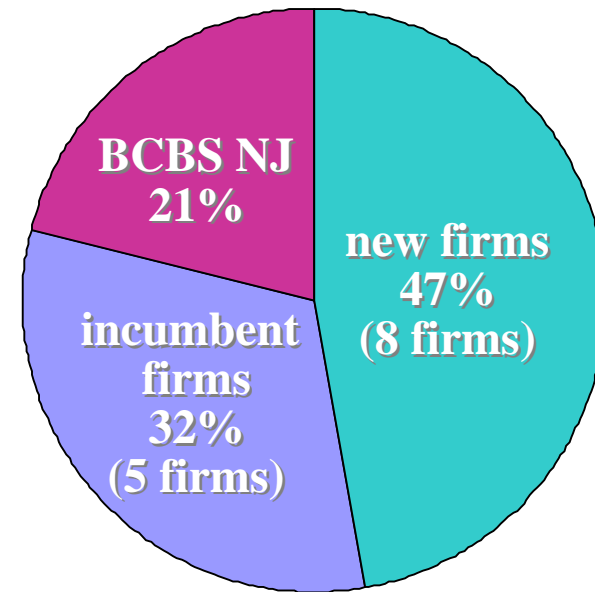
“Entrants” captured 47% of HMO/POS enrollment in Atlantic City/Cape May from January 1994 to December 1998. BCBS’s share fell 17 percentage points.

January 1994



Enrollment = 74,730

December 1998



Enrollment = 88,703

- Largest Firm in 1994
- Other Existing Firms in 1994
- New Firms

Source: InterStudy HMO Trend Report

Source: New Jersey Managed Care Bureau

Indicia Commonly Used to Evaluate Harm to Competition in Health Insurance Markets

- § Market shares and share-based market concentration statistics**
- § Medical loss ratios or profit margins**
- § Elasticities of demand, which measure the degree of consumer price sensitivity**

Market Shares and Share-Based Market Concentration Statistics

- § Market shares are typically a restatement of one's conclusions about market definition**
- § Analyses of market shares often cannot reveal the underlying competitive dynamics**
 - § Market share is not a useful indicator of a firm's ability to compete for business when expansion or entry is accomplished easily**
 - § In a bidding environment, aggregate market shares tend to be a poor indicator of competitive viability**

Market Shares and Share-Based Market Concentration Statistics

- § Analyses of market shares often cannot reveal the underlying competitive dynamics**
 - § Marketwide enrollment and shares hide much competitive activity and churn**
 - § Market share is also an indicator of relative efficiency or quality**
 - § Enrollment and shares often do not account for all of the ways that health insurance can be arranged**
 - § Data are generally available for HMOs, but data on PPO enrollment are much poorer**

Indicia Commonly Used to Evaluate Harm to Competition in Health Insurance Markets

- § Studies of shifts in market shares over time**
 - § One way to test whether entry and expansion, is in fact, easy and effective**
 - § However, aggregate data will still understate the enrollment and disenrollment “churn” that reflects consumer switching**

Indicia Commonly Used to Evaluate Harm to Competition in Health Insurance Markets

- § Evaluating changes in and levels of profit margins or medical loss ratios over time**
 - § A high and persistently low medical loss ratio (i.e., higher profit margins) could be consistent with market power**
 - § There are still issues of measurement and interpretation:**
 - § Medical loss ratios tend to vary widely by product and is influenced by the nature of the services provided by the health plan

Indicia Commonly Used to Evaluate Harm to Competition in Health Insurance Markets

- § Econometric studies of elasticities of demand**
 - § A high elasticity of demand would suggest that consumers are willing to switch health plans in response to changes in price, which would be a finding consistent with competition**
 - § The elasticities can be used to simulate the price effects of a merger**

Conclusion

- § **Health insurance markets have many features that help to ensure competition**

- § **These conditions reflect:**
 - § **the competitive pressures facing health plans and**
 - § **the competitive tools available to employers and individual consumers**

Summary: “50 Ways to Leave Your Health Plan”

- § **Just slip out the back, Jack**
 - § (and turn to another health plan, which is made easier by the willingness of individual consumers to switch plans)
- § **Make a new plan, Stan**
 - § (because, with the help of brokers and consultants, health insurance can be arranged in a number of ways)
- § **You don't need to be coy, Roy**
 - § (because employers are informed and sophisticated)
- § **Just get yourself free**

Summary: “50 Ways to Leave Your Health Plan”

§ **Hop on the bus, Gus**

§ (because health plans can expand easily across geographic and product space)

§ **You don't need to discuss much**

§ (because competition takes place in a bidding environment)

§ **Just drop off the key, Lee**

§ (because the key is effective entry)

§ **And get yourself free**

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