

Mgmt 444

Insurance Market Spillovers

“Medical Bankruptcy”

You may have heard politicians state that half of all bankruptcies in the U.S. are due to health care spending

This is a misstatement of a famous research paper, which itself has met with withering criticism for both its methods and conclusions

Study by Himmelstein et al. published in Health Affairs in 2005

- Surveyed several hundred individuals who had filed for bankruptcy
- Slightly more than half had a health “event” in prior two years, including auto accidents, pregnancy, and out of pocket spending exceeding \$1000
- Authors do not establish whether individuals would have filed for bankruptcy had it not been for these events
- Authors do not establish conclusions that only a Canadian style system would prevent these bankruptcies
- Critics of this paper were charged with minimizing the problem of the uninsured

But there is compelling evidence of the importance of insurance

- Cook, Dranove and Sfekas show that near-elderly uninsured individuals who fall seriously ill stand to lose, on average, 30-40% of their accumulated assets (see handout)
- This controls for trends among all uninsured, and among all who fall ill, using “triple difference” methods that I describe below

The Role of the Employer

Most privately insured Americans obtain their insurance through their employers, who have long complained about how rising healthcare costs are eating into their profits

U.S. companies assert, in effect, that they bear the costs of health care benefits

Q: What does Pauly say? What is his argument?

Q: So why the disconnect? Do workers or firms suffer when health care costs rise? Does it matter?

Research evidence is fairly convincing: Employees do bear most of the burden of rising health care costs

Spillover effects of adverse selection and cream skimming

There is a broad class of consequences of employer-sponsored coverage that Pauly does not address. Madrian's article discusses them. I will summarize what she reports in that paper as well as some findings from related studies

- Towards the end of the paper, Madrian also reports that research supports Pauly's contentions. But let's focus on other issues
- The "labor market effects" of coverage result from two factors:
 - 1) When coverage is tied to employment, workers who leave their job may lose coverage
 - 2) Insurer have used tactics to limit "hit and run" purchases by patients with emerging health care problems; these tactics apply without prejudice to those who seek new insurance merely because of their employment situation

- The consequences, as described by Madrian, include:
 - . Reduced rates of early retirement
 - . Reduced job switching (“job lock”)
 - . Differential employment in small firms

- Most of these problems were especially prevalent prior to both the Comprehensive Omnibus Budget Reconciliation Act (COBRA) of 1983 and the Health Insurance Portability and Accountability Act (HIPAA) of 1996
 - . Indeed, it was precisely these problems that led to many of the provisions of COBRA and HIPAA, which we will discuss
 - . Most of the critical research evidence precedes HIPAA but is crucial to informing current policy

Evidence on early retirement

- Individuals may forestall early retirement so as to maintain employer coverage
 - . Research suggests that guaranteed continuation of coverage after retirement increased the likelihood of early retirement by 30-80 percent.
 - . Normally, about 4 percent of individuals retire each year between age 60-64, so guaranteed coverage would raise the rate to 5.2-7.2 percent annually
 - . COBRA enabled workers to continue coverage after retiring, and appears to have increased the probability of retiring by 30 percent, which is consistent with the research findings

- Medicare affects incentives to retire
 - . Medicare eligibility begins at 65, as does social security, making the effects hard to disentangle
 - . Those about to become eligible for Medicare who have older spouses were more likely to retire than those with younger spouses, suggesting that they were concerned about losing family coverage at work

Medicaid and incentives to join the labor market

- Just as individuals risk losing insurance if they retire before they qualify for Medicare, they may risk losing insurance if they are enrolled in Medicaid and join the labor force
 - . Medicaid covers low income families with dependent children, usually single parent households.
 - . These individuals when transitioning from Medicaid often obtain low paying jobs that do not provide insurance
- These facts suggest that mothers eligible for Medicaid may be reluctant to work if they believe they will lose coverage
 - . Despite more than a dozen studies, the findings are mixed
 - . The overall conclusion seems to be this is not a major factor

Spouse's coverage and incentives to work

- Most employers who offer insurance give workers the option of purchasing family coverage
 - . One can normally obtain insurance through a working spouse
 - . By same token, one can work and provide insurance for a nonworking spouse
- Research here is more consistent
 - . An individual is much more likely to seek work if their spouse lacks coverage
 - . For example, if an individual switches to a job that does not offer coverage, that individual's spouse is more likely to seek work
- Q: If you are an employer, do you worry about whether your employees are married and may have access to spousal coverage?

Job Lock

- Insurers used to impose waiting periods for coverage
 - . When you first signed up for a policy, that policy either did not kick in for some period of time, or only covered new illnesses (i.e., there were preexisting condition exclusions).
 - . The waiting period before full coverage kicks in could be 18 months
- Economists hypothesized that these restrictions might limit the desire of workers to change jobs
- Most influential paper was written by Madrian
 - . Relied on 1987 survey of 14,000 households
 - . Has info on insurance status, employment status, and limited demographic information
- Madrian's test for job lock does is follows: Do insured individuals at risk for high health expenditures change jobs less often than insured individuals not at risk?
- Of course, individuals at risk for high health expenditures may change jobs less often for reasons unrelated to insurance
- To sort out these effects, Madrian sets up the following table

	Employer-Provided Health Insurance	
	No	Yes
Wife Not Pregnant	M_{00}	M_{01}
Wife Pregnant	M_{10}	M_{11}

- M is a measure of mobility (the fraction of individuals in this category who changed jobs)

- $M_{01} - M_{11}$ is a crude measure of job lock
 - . It captures differences in mobility between those expecting high expenditures and those who are not
 - . E.g. $M_{01} \approx .06$ $M_{11} \approx .02$ "Lock" $\approx .04$
 - . But we cannot determine whether this "lock" reflects insurance concerns or pregnancy-induced inertia
 - . That is, husbands may be reluctant to change jobs if their wives are expecting, regardless of insurance status

- Madrian proposes another measure that controls for health status

- The adjusted measure of job lock is $(M_{01} - M_{11}) - (M_{00} - M_{10})$
 - . First parenthetical term is difference in propensity to switch jobs based on whether or not woman is pregnant, for those with insurance (and possibly concerned about losing it)
 - . Second term is difference in propensity to switch jobs based on whether or not woman is pregnant, for those without insurance (and thus unconcerned about losing it)

- This is known as a *differences in differences* ("DD") estimate.
 - . We take the difference between "wife pregnant" and "wife not pregnant" in both the study group (those who have insurance) and the control group (those without insurance)
 - . The DD estimate is a measure of job lock

- Overall, Madrian finds that $M_{00} \approx .12$ and $M_{10} \approx .10$
 - . This gives us Job Lock = $(.06-.02) - (.12-.10) \approx .02$
 - . Thus, for individuals with high expected health care costs due to pregnancy, about 1/3rd of potential job changes do not occur due to concerns about losing insurance

- In addition to pregnancy, Madrian also considers family size as a predictor of health care costs, again finding evidence of job lock

Q: Why should we care about job lock? How might we determine the burden of job lock on the U.S. economy?

Other studies also find evidence of job lock, but find smaller magnitudes

- Kapur reexamines the data used by Madrian

- . Econometric theory shows that difference in difference methods are unreliable if $M_{00} \gg M_{01}$ or $M_{00} \ll M_{01}$ (i.e., the experimental and control groups are too dissimilar)
- . This is the case using Madrian's approach: those with insurance are much less likely to change jobs than those without insurance

- Kapur's comparison table looks like this:

	Spouse has Employer-Provided Health Insurance	
	Yes	No
Wife Not Pregnant	M_{00}	M_{01}
Wife Pregnant	M_{10}	M_{11}

- The measure of job lock is the same: $(M_{01} - M_{11}) - (M_{00} - M_{10})$

- . Workers whose spouses lack insurance are concerned about losing insurance; whereas workers whose spouses have insurance are not
- . Again, $M_{01} - M_{00}$ measures job lock
- . Kapur's estimates of job lock are much smaller than those reported by Madrian

Madrian summarizes the overall literature and concludes that the best available evidence confirms that job lock is a sizable problem

Madrian also discusses how health insurance affects the demand for labor

- Because the cost of insurance is effectively fixed per worker, this gives firms incentives to hire fewer workers at longer hours
- Tax laws require that firms giving health insurance to some full-time workers give it to all of them. This does not apply to part-time or seasonal workers
 - . This gives firms incentives to use part-time workers in place of full-time workers for whom they do not want to provide insurance (e.g., low wage workers for whom the minimum wage provides a floor to the wage/benefits tradeoff)

Madrian's paper describes a host of labor market consequences of employer-sponsored health insurance.

- Policy analysts believe that the problem of job lock is more important than any of the other problems
- Thus, regulatory intervention in the labor market/insurance nexus has focused on continuation of coverage
- I have mentioned COBRA and HIPAA. Both are still in force; let's briefly explore how they work

COBRA of 1983 included a key provision for job changers

- An individual who left a job would be eligible to continue purchasing insurance through the old employer's group for up to 18 months.
 - . The old employer could charge that individual no more than 102 percent of the average group premium.
 - . If the individual got a new job, the new employer could even pick up the tab for the COBRA coverage until the waiting period ended

- Madrian and Gruber document that COBRA had a positive impact on labor markets.

- . 65 percent of workers without an alternative source of insurance chose to obtain COBRA coverage.
- . For older workers, the availability of continuous coverage increased the likelihood of early retirement by a third.
- . For younger workers, COBRA cut job lock almost in half.

- COBRA did not work perfectly.

- . About one third of individuals who lacked alternative coverage chose not to invoke COBRA.
- . COBRA failed to protect individuals who had dropped out of the labor force for more than 18 months. It also did nothing for employees whose companies stopped offering coverage

- COBRA imposed an administrative burden on employers

- . They had to process COBRA payments from ex-employees for a period of up to 36 months.
- . Gruber and Madrian placed the cost at over \$10 billion annually.

HIPAA of 1996 was intended to fix these problems.

- HIPAA allows workers to count past uninterrupted insurance coverage towards any waiting periods required for new coverage.

- . Most workers who change jobs can now obtain immediate coverage from their new employer.
- . They do not have to worry if their old employer stops offering coverage and old employers do not need to keep close tabs on workers who take new jobs.

- HIPAA also creates some new problems.

. Employers used waiting periods to defend against adverse selection; smaller insurers may be unable to afford the exposure to a major claim by a new employee

. Some wonder if HIPAA explains why insurance offer rates by small employers declined 68% in 2000 to 59% in 2005.

. Though HIPAA reduces the need for employers to track the insurance status of old employees, it now requires employers to learn about prior insurance status of new employees.

Additional Topics related to Employer Health Insurance

Self-insurance

The vast majority of large firms, and many medium-sized firms, offer at least one plan that is *self-insured*

- Company bears financial risk

- Third party handles contracting, claims, and other administrative services

- Firms may obtain “stop-loss” through reinsurers but this is limited by rule. Firms must bear some nontrivial financial risk if they are to be self-insured

. Q: Is this risk greater than if they were to purchase insurance from an insurance company?

- Self-insurance enables firms to avoid state insurance laws

. Laws include benefits mandates and taxes

. Taxes usually amount to 1% or 2% of premiums

. *Mandates* can be much more costly

- Curiously, there is no systematic evidence that self-insurance saves money

Crowd-out

There have been many efforts over the years to expand health insurance coverage, for example through the guarantee of coverage to all low income children

Q: What does the cynic in you think will happen in the private sector when these programs are instituted?