Competitive Insurance Markets with Limited Commitment

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ABSTRACT

We study the problem of commitment in competitive insurance markets, where risk-averse agents can walk away from their plans at any time and insurers can exit the market if they become unprofitable. In equilibrium, optimal contracts are stationary and can be characterized by a premium and a stop-loss. We show that competition gives rise to endogenous contract dispersion with some firms offering attractive plans featuring high premiums and high coverage, and other firms offering unattractive plans featuring low premiums and low coverage. This contract dispersion punishes agents from quitting one contract and reentering the market at a later date. We use the model to discuss the impact of individual mandates, minimum standards on insurance, and requirements on hospitals to provide emergency care.