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Introduction to the 2010 Special Issue of JRI on Health Insurance

We are pleased to publish this special issue on health insurance, which coincides with a wave of health care reform in the United States. The debate over health care reform is much broader than the insurance coverage of health services, although health insurance is an important financing tool that affects many market participants. In fact, health insurance introduces, among other things, distortions in resource allocation by increasing access to health, by modifying the demand for and the supply of health care services, by changing individuals' incentives for health prevention, by affecting worker absenteeism and productivity, by increasing the financial obligations of firms, and by smoothing consumption over time.

Scott Harrington proposes a comprehensive overview of the U.S. health care reform (as of early December 2009) with a focus on health insurance. His article presents the three main motivations for the reform: (1) high and rising annual growth of per capita expenditures in health expenditures not necessarily leading to a higher average quality of health for the population, (2) lack of access to insurance coverage of about 48 million residents, and (3) Medicare deficit and Medicaid cost growth. The author outlines the health care reform bills in the U.S. House and Senate, including the key provisions for expanding and regulating health insurance, and projections of the proposals' costs, funding, and impact on the number of people with insurance. The article also discusses other issues related to the reform: (1) the potential effects of mandated health insurance in conjunction with proposed premium subsidies and health insurance underwriting and rating restrictions, (2) the proposed creation of a public health insurance plan, and (3) provisions that would modify permissible grounds for health policy rescission and that would repeal the limited antitrust exemption for health and medical liability insurance. It concludes by contrasting the reform bills with market-oriented proposals and an outlook on future developments.

The remainder of the special issue comprises analyses of health insurance issues that will continue to hold whatever the chosen reform. One important research question is the effect of asymmetric information on the functioning of insurance markets and particularly on health insurance. Alma Cohen and Peter Siegelman review the empirical literature on adverse selection in insurance markets. They focus on empirical tests of the basic prediction of adverse selection, namely, that policyholders that purchase more insurance coverage tend to be riskier. They observe that when such a correlation exists, it varies across insurance markets and pools of insurance policies. They discuss various reasons why a coverage–risk correlation may not be found in some markets. The presence of a positive coverage–risk correlation can also be explained by

moral hazard, and the authors discuss methods for distinguishing moral hazard from adverse selection. Finally, they analyze how learning by policyholders and insurers can affect conclusions about the presence of asymmetric information in insurance markets.

The next three articles deal with health care spending but do not analyze asymmetric information in detail, although this problem may be present in their data. Anthony T. Lo Sasso, Lorens A. Helmchen, and Robert Kaestner use a unique data set from an insurer to analyze the effects of consumer-directed health plans on health care spending. They conclude that the marginal dollar contributed by the employer to the spending account is entirely spent on outpatient and pharmacy services. In contrast, out-of-pocket spending is not responsive to the amount the employer contributes to the spending account. The magnitudes of the effects suggest important health care spending consequences of higher employer contributions to spending accounts. Their findings could be explained in part by moral hazard.

Employers may offer employees a choice of health plans either to promote competition among plans or to better cater to employees' preferences for different types of products. Kate Bundorf examines whether the relationship between the availability of choice is consistent with these motivators of employer behavior. The article finds that employers that offer choice have lower average premiums, primarily because employees are enrolled in less generous plans, and cover a greater proportion of workers than those that do not.

Richard Dusansky and Çağatay Koç study the implications of the interaction between insurance choice and medical care demand. They break the gross price elasticity of demand for medical care down into two separate components: the medical care gross price elasticity of insurance choice and the cost sharing elasticity of medical care. When consumers alter their choice of health care plans, the price elasticity of medical care is no longer equivalent to the cost sharing elasticity; using the latter as a proxy for the former may thus produce misleading results. They present conditions under which the medical care price elasticity can be positive and provide a theoretical foundation for the empirical finding of a positive medical care price elasticity of insurance demand.

The next four articles are concerned with information problems, while the last article analyzes permanent disability ratings in workers' compensation systems. James H. Cardon examines the interaction of flexible spending accounts (FSAs) and conventional insurance under asymmetric information. He shows that FSA availability can break a separating equilibrium because high-risk types might prefer the lower-coverage contract supplemented with FSA funds. In this case a Pareto-inferior separating equilibrium may exist. Further, FSA availability alters the optimal pooling contract. Employers can reduce coverage levels, raising expected utility for low risk types, and can compensate high-risk types by offering supplemental FSA coverage. Thus, it is possible that FSAs strengthen pooling contracts.

Angus Macdonald and Pradip Tapadar study the effect of genetic information on insurance contracting. If genetic information continues to be treated as private, adverse selection becomes possible. Adverse selection does not appear unless purchasers are not very risk averse and insure a small proportion of their wealth, or unless the

elevated risks implied by genetic information are implausibly high. In many cases adverse selection is impossible if the low-risk stratum of the population is large enough. They find no convincing evidence that adverse selection is a serious insurance problem, even if information about genetic disorders remains private.

Kyoungrae Jung examines incentives for voluntary disclosure of quality information by health maintenance organizations (HMOs). Economic theory predicts complete voluntary disclosure without mandatory rules. The author introduces plans' selection motives to avoid high-risk consumers as a deterrent of full unraveling; if disclosure is expected to attract high-risk members, plans have incentives to withhold information. The empirical analysis shows that while market unraveling was an important mechanism to bring about disclosure, it was not complete, and plans in markets with high-risk consumers were less likely to disclose.

Conventional economic theory predicts that medical insurance coverage causes an inefficient production of health because of *ex ante* and *ex post* moral hazard effects. Laurie J. Bates, Kankana Mukherjee, and Rexford E. Santerre empirically analyze the impact of medical insurance on the technical efficiency of health production at the metropolitan level. Their underlying health production function allows for preventive care, curative care, and behavioral factors. Their regression results indicate that insurance coverage generates inefficiency, but the efficiency loss appears to be relatively small on the extensive margin.

Jayanta Bhattacharya, Frank Neuhauser, Robert Reville, and Seth Seabury study the effectiveness of disability ratings using data on ratings and earnings for a large, representative sample of permanent disability claimants in California. They find important and persistent differences in average earnings losses for similarly rated impairments in different parts of the body. They then explore how adjusting permanent disability ratings to reflect cross-impairment differences in earnings losses can affect the equity of permanent disability benefits. They obtain that the adjusted ratings reduce cross-impairment differences substantially. The adjusted ratings result in a more equitable distribution of disability benefits across workers with different impairments.

Georges Dionne
HEC Montreal
georges.dionne@hec.ca

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