Unit 2: Can we think of health as capital ?

3. The challenges of health insurance

Hello, I am Léa Toulemon a postdoc researcher with Hospinnomics. Today, I will explain what health insurance means to economists. First, I will explain the purpose of health insurance. Then, I will explain the two threats to health insurance systems which are adverse selection and moral hazard. What is health insurance? First, let's define health insurance. It is a system that covers the financial risks linked with a poor health status. There are two types of financial risk: the cost of health care and the potential loss of income as poor health may hinder one's ability to work. The health care market is a unique market for many reasons. These factors make health insurance essential. Why is health insurance essential? What are these factors? Firstly, the demand for health care is not regular or predictable. It can change every year and it is difficult to anticipate. Secondly, the costs of being sick can be very high due to the cost of health care itself as well as the potential inability to cover it because a serious illness might make working impossible. The high costs and uneven demand push people to seek health insurance. What is the goal of health insurance? Health insurance has two main goals. One is to share risks between the sick and the healthy. The other is more about efficiency because, on an individual level people tend to be what we call risk-averse i.e. they would prefer to pay a foreseeable fee every year, so health insurance, rather than run the risk of paying a steep price if they get sick. This means that beyond risk sharing individuals can benefit from being insured. Health insurance, despite being very useful is difficult to implement for several reasons such as what we call asymmetric information. This is a situation where one party has more information than the other. In this case, insurers and policyholders. Policyholders are likely to have more information about their risk of getting sick and about their own behavior, efforts, and health care consumption. The first consequence of asymmetric information is what we call adverse selection. The probability of getting sick is different for everyone. This may be caused by family medical history different behaviors age, etc. – there are many factors. Policyholders tend to know these risks better than insurance providers. Insurers know about average risk levels but not about individual ones. Insurance rates will therefore usually correspond to the average risk of a population. People with lower risks – e.g. students, young people or healthy people – will find that these average rates are too high for their own risk level. They will not want to pay such high prices and thus will not get insurance hence adverse selection as healthier individuals will forgo insurance thereby reducing the risk sharing effect. When healthier people withdraw from their insurance policy the collective risk level of those who remain is then higher than before. Insurers will increase their rates and the healthiest people in this new group will also withdraw. Eventually, if we follow this line of reasoning there will be no one left. Adverse selection therefore threatens the very existence of health insurance. Several solutions exist to counteract this problem. One would be to adapt rates to individual risks. But this solution is very unfair as the most sick people would pay the highest prices. Another issue is that insurers have no information about individual risks. They may have an approximate idea, through indicators such as age but policyholders have no reason to disclose their risks to their insurance provider. The second option which is more paternalistic and coercive is mandatory health insurance. The advantage is that even low-risk people are covered and rates can be kept reasonable thereby ensuring true risk sharing. Adverse selection is a threat to insurance coverage from the moment it is taken out.

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I will now tackle moral hazard which is also caused by asymmetric information but which this time involves people who already have insurance and how they behave. It is not about risk itself but about their behavior. Moral hazard is an ill-chosen term, as it is not about morality. It just means that the newly-insured change behavior and that they consume more. People either consume too much when insured or too little when not insured. This is easy to observe: insured people consume more. Moral hazard means we cannot just look at how much people spend when uninsured and then offer corresponding rates. Once they have insurance people behave differently. The mere fact of being covered influences people's minds. This can lead to ridiculous situations. I want to get health insurance for my current consumption level but if everyone is covered they will all consume more so rates will be too high and coverage will be unaffordable. We could counteract moral hazard if we had symmetry of information because we could determine individual needs regarding health and thus regulate demand. This is a complicated topic as an optimal level of health care consumption does not exist, or is at least very hard to define. Even if there was one, insurers might be unaware of it. One way to see whether health care coverage causes overconsumption is to look at whether, with insurance, higher health care consumption leads to better health. If consumption increases with no effect on health it is not very efficient. But if there is an improvement it means people used to forgo care. Curbing moral hazard therefore usually means that fewer people are insured. There is no ideal solution. One could stem moral hazard by reducing insurance for non-essential care. Essential care is usually well covered and does not tend to lead to overconsumption as demand is not influenced by insurance such as with hospital care. If I broke my leg for example, I would go to a hospital even without insurance. Less coverage would be provided for care considered non-essential such as some dermatological care eye care or dental care. The problem with this is that a losing party remains: preventive care. It is often hard to distinguish preventive care from non-essential care. If I go to the doctor for a headache, is it prevention or overconsumption? It's hard to tell. Another solution is partial coverage through coinsurance or deductibles. The problem is that these are often paid for by a few, very sick people which creates equity issues. To conclude, health insurance is an essential part of the health care system. It allows risks to be shared between the sick and the healthy. The important thing when implementing health insurance is to bear in mind that the insurance itself will influence people's choices and behavior. In this video I described two things we need to be aware of when implementing health insurance: adverse selection and moral hazard. Adverse selection is the fact that healthy people will often forgo insurance if it is not mandatory. Moral hazard is the fact that people will consume more if they are insured.