Issue Brief
Findings from HSC

THE INDIVIDUAL HEALTH INSURANCE MARKET:

Researchers, Policy Makers Seek Common Ground on Tax Credits for the Uninsured

As policy makers in Washington consider the use of tax credits to encourage uninsured Americans to buy health insurance, researchers and policy experts debated the merits of the individual health insurance market at a conference sponsored by the Center for Studying Health System Change (HSC) and Health Affairs. *One presenter estimated that the individual market "works acceptably well for about 80 percent of potential buyers" but is unlikely to help the remaining 20 percent, who suffer from the worst health. Another presenter argued that the individual market "is not a good place to target substantial new resources aimed at lowering the number of uninsured persons." A proposal that intrigued many conference attendees is to have the federal government serve as a reinsurer of the individual market "by assuming responsibility for most of the costs of people in the highest 2 percent to 3 percent of the national spending distribution."*

Growing Interest in Health Insurance Tax Credits

Tax credits to help people buy individual or nongroup health insurance are a key part of the national debate over how to reduce the number of uninsured Americans. President Bush and members of Congress from both political parties have proposed tax credits for low-income individuals and families, but reliance on the individual market has drawn sharp criticism from those who believe the market is badly flawed and is not the best avenue for expanding coverage. On October 23, HSC and *Health Affairs* sponsored a conference to explore divergent views on the individual market and policy options for a tax credit approach. *Health Affairs* also published a special online issue examining these questions.[1]

Reflecting the keen interest in this topic on Capitol Hill, the conference drew a standing room only audience of almost 300 analysts. The objective of the meeting, HSC President Paul B. Ginsburg said, was "to dig beneath the surface and explore what we know, what we don't know and what we need to find out about this market."

The 108th Congress is certain to focus renewed attention on individual tax credits. House Speaker Dennis Hastert (R-Ill.) recently said increasing the number of Americans with health insurance is a top priority for the new Congress and the President.

A Shrinking Market Shows Signs of Promise

The individual health insurance market served an estimated 8.6 million Americans in 2001, down 11.5 percent from 1997, according to Mark Pauly of the University of Pennsylvania, who presented an overview paper he co-authored with HSC Vice President Len Nichols. Administrative costs are higher in the individual market than in the group market, primarily because it costs insurers more to sell policies to individuals. The nongroup market also suffers from adverse selection, since those who seek coverage on their own are more likely to have health problems.

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"The nongroup market works passably well, even for high risks... . Perhaps 80 percent of nongroup households have access to acceptable premiums."
– Mark Pauly, University of Pennsylvania

"The individual market cannot guarantee everyone access. You are virtually 100 percent likely to be turned down if you have HIV, arthritis, brain injury, cancer, diabetes, epilepsy, heart disease... ."
– Karen Pollitz, Georgetown University

"Whether you think the individual market is a good place to buy or not, many people have to buy there, and they do need assistance."
– Janet Stokes Trautwein, National Association of Health Underwriters

"The word, 'crummy,' comes to mind when I think about the individual market."
– Steven B. Larsen, Maryland Insurance Commissioner

"On the face of it, high-risk pools should work just fine... . However, they don't, and their failures are stunning."
– Deborah Chollet, Mathematica Policy Research

Despite its shortcomings, Pauly and Nichols concluded "that the individual market works acceptably well for about 80 percent of potential buyers." These are primarily people in good health with incomes high enough to afford coverage, but some with health problems also find coverage at acceptable prices. However, Pauly and Nichols also found the individual market is unlikely to work well for the roughly 20 percent of those eligible who are in poor health, especially those with low incomes. Efforts to force insurers to take all comers or to limit premiums "have uniformly reduced coverage in states that have tried it," Pauly told the conference. State-run high-risk pools can help stabilize the rest of the individual market, he added.

HSC researcher Jack Hadley estimated that 7 percent of people with individual insurance are in fair or poor health, compared with 21 percent of the uninsured. His conclusion: either those who buy individual coverage are healthier, or the market screens the sicker ones out. Tax credits indeed would provide substantial help for many healthy and younger uninsured Americans but would need to be adjusted for age or health status if they were to help the "sicker, older, poorer uninsured," Hadley said.

Tax Credits Could Help "Millions"

Providing tax credits to people who are uninsured "would enable millions of people to purchase health insurance," said Katherine Baicker, an assistant economics professor at Dartmouth University and former economist for the White House Council of Economic Advisers. President Bush's proposal to provide credits of up to $1,000 for individuals and $3,000 for families would help six million uninsured Americans get insurance, Baicker added.

Baicker noted that 80 percent of uninsured families have someone in the workforce, and 60 percent have incomes above the poverty line. Any policy to reduce the number of uninsured must be flexible, she added. "No single approach is going to... capture them all." She stressed the importance of coupling tax credits with expanded subsidies to high-risk pools. The Trade Adjustment Assistance Reform Act moves in this direction, providing tax credits to workers who lose jobs due to trade, along with $80 million in new funding for state high-risk pools.

"Not Ready for Prime Time"

Karen Pollitz of Georgetown University's Institute for Health Care Research and Policy argued against increased reliance on the individual market. "The current market makes coverage less accessible, less affordable and inadequate to meet the needs of many people without insurance, especially those who have modest incomes or are in less-than-perfect health," she said. Her presentation, based on a paper co-authored by HSC Senior Researcher and Public Affairs Director Richard Sorian, drew on earlier research done on the individual market.[2] Pollitz and Sorian presented insurers with applications from seven fictitious people with health problems, ranging from hay fever to depression to HIV infection. The applications were rejected 37 percent of the time, and many of the other policies came with riders that restricted benefits and/or charged higher premiums.

One approach to resolving these concerns is "better risk spreading," said Maryland Insurance Commissioner Steven B. Larsen. "Health insurance is a quasi-public or public function [that is] delivered by the private marketplace. If we acknowledge that it's a public function, then maybe we're more comfortable with a much greater level of regulation than we have today."

Mark Hall, professor of law and public health at Wake Forest University, questioned the notion that proffering tax credits could solve the individual market's problems. Policy makers cannot just wave "a magic wand" and make the individual market operate like the group market, Hall said. He suggested expansion of group coverage

might be more practical with alternative subsidy vehicles.

Insurers View Market Favorably

Janet Stokes Trautwein of the National Association of Health Underwriters said policy makers should focus on the millions of people who are well-served by the individual market. "Contrary to some assertions, coverage for [the chronically ill] is widely available, and benefits will not always be greatly restricted." Some policies are a good buy, even with riders or exclusions, she said.

Tom Miller, director of health policy studies for the Cato Institute, dismissed adverse selection as "a trumped-up bogeyman." The individual market is small because the tax system is so tilted in favor of employer-sponsored group insurance, he said. Regulatory mechanisms that block insurers' ability to select their customers have failed. "They don't make individual insurance more available to high-risk consumers because they drive the low-risk people out of a thinning voluntary individual market, and they raise overall premiums," Miller said.

Leaders of two major insurers expressed bullish views about the individual market. Thomas B. Hefty, CEO of Cobalt Corp., and its Blue Cross and Blue Shield United of Wisconsin, and John Bertko, chief actuary for Humana, Inc., said sales of individual policies are growing rapidly in their markets.

Hefty said the uninsured rate in Wisconsin, which does not limit premiums, is half the national average. Wisconsin is among 10 Midwestern states where more residents are enrolled in private plans than in Medicaid or other government programs, he noted. Purchasers include "young people...baby boomers and early retirees in particular who have fallen out of the [group] market." He suggested that bad public policy, not a bad market, was responsible for other states' high rate of uninsured. If families know they can get public coverage if they get sick, they won't buy private coverage while they're healthy, he said.

Humana, a newcomer to the individual market, sees "big opportunities," Bertko said. Half its applicants for individual coverage "go through clean and get a policy issued," he said, but 10 percent to 20 percent may be uninsurable. Adverse selection is a big problem. "People seek insurance because they need it," Bertko explained.

High-Risk Pools Offer Some Help

Thirty states have established high-risk pools for the medically uninsurable. Minnesota stands out with 6 percent of covered lives in its high-risk pool; Oregon and Nebraska each have 2 percent. The other pools cover less than 1 percent.

"Risk pools, as they exist today, serve a small but important niche," said Bruce Abbe of Communicating for Agriculture. "They provide a guarantee that everyone in the insurance market has a place to buy insurance if they're willing to." Risk pools aren't perfect, Abbe added, but they provide a significant subsidy limited by funding constraints.

Deborah Chollet, a senior fellow at Mathematica Policy Research, Inc., noted that most high-risk pools have experienced problems that mirror those of individual markets. The coverage is expensive, waiting periods long and benefits limited, she said. Some of their failures "are stunning," according to Chollet. Florida shut down its pool because of inadequate funding, and California, Illinois and Louisiana have capped enrollment and periodically barred new entrants.

All high-risk pools have waiting periods before covering preexisting conditions, and they charge 25 percent to 100 percent above standard premiums. Most strictly limit mental health benefits, and 10 do not cover maternity. "There's a lot of leakage in this 'fix,'" said Chollet. She also noted that insurers prefer high-risk pools to more state regulation. Those who see the glass as half-full argue that high-risk pools provide better protection than nothing, and Abbe noted most people use them as transition bridges either to Medicare or back to group coverage.

"There will always be an individual market... .We should not ignore it if we want to reduce the [number of] uninsured."
– Bruce Abbe, Communicating for Agriculture

"Is the individual market better than nothing? Certainly. Is it better or equivalent to the group market? That's where the real problems lie."
– Mark Hall, Wake Forest University

"If the government were the reinsurer, we would end up solving the adverse selection problem... .We'd spend much less money trying to screen out very high-cost people."
– Katherine Swartz, Harvard University

"If we all agree some people could be served by this market, but others cannot...it shouldn't be too much rocket science for analysts...to devise policy options that real people [legislators] could pass."
– Len Nichols, HSC

Notes

1. See "The Nongroup Market: A Web Symposium," *Health Affairs* (October 2002), available online at www.healthaffairs.org/WebExclusives/Nongrp_TOC.htm.
2. Pollitz, Karen, Richard Sorian and Kathy Thomas, *How Accessible Is Individual Health Insurance for People in Less-than-Perfect Health?* Report for The Henry J. Kaiser Family Foundation (June 2001), available online at www.kff.org/content/ 2001/20010620a/.

This Issue Brief is based on a conference sponsored by HSC and *Health Affairs*, titled "Individual Health Insurance: Fact, Opinion and Policy," held October 23 in Washington, D.C. Moderators were HSC President Paul B. Ginsburg and *Health Affairs* Founding Editor John Iglehart. For a full list of presenters, transcript and webcast of the conference, go to *www.hschange.org.*

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Government as Reinsurer

An idea that sparked wide interest at the conference came from Katherine Swartz, professor of economics and health policy at the Harvard School of Public Health. She proposed having the federal government assume the role of reinsurer for buyers of individual coverage with the steepest medical bills. Swartz said the government should step in for those with the most expensive 2 percent or 3 percent of health care costs. Carriers would still bear responsibility for most medical expenses, but not the catastrophic costs that attend a serious accident or life-threatening illness. Much of the underwriting insurers do to avoid the worst risks is futile, Swartz said, because "it is really impossible to predict who will be a very, very high-cost person." People in the top 5 percent one year seldom are in the top 5 percent the next, she said.

"If the government were the reinsurer, we would end up solving this problem," Swartz said. The government already plays the role of reinsurer for natural disasters, having bailed out the airline industry after the September 11 attacks, and it assumes responsibility for the worst-risk mortgages, she noted.

Views from Capitol Hill

Senior congressional staff also weighed in. David Nexon, health staff director for the Senate Health, Education, Labor and Pensions Committee, offered the most pungent commentary. "There's an old saying that you can put lipstick on a pig—but it's still a pig," Nexon said. With steep administrative costs, the individual market is no way to help the uninsured, Nexon added.

But Patrick Morrissey, deputy chief of staff on the House Energy and Commerce Committee, said he viewed the task at hand as refining a market to make it work better. Consumers want to make their own health care choices, Morrissey said, and tax credits will provide that flexibility. Any solution will require "a viable high-risk pool system."

Elizabeth Fowler, chief health and entitlements counsel for the Senate Finance Committee, said Democrats might resist expanding tax credits until they see how the tax credits provided for in the trade act work out. "I do think it would be difficult to reach agreement on uninsured policies in the coming Congress without going down the road of an individual tax credit in some form," Fowler said, along with an expansion of public programs.

Finally, Dean Rosen, Republican staff director on the Senate HELP Public Health Subcommittee, recalled that in E.B. White's classic, *Charlotte's Web*, the enterprising spider of the title helps people to view the pig in a more positive light. The current individual market is small and fragile, Rosen said, but people shouldn't look at it as it is now, "but [as] how it can be."

Finding Common Ground

Despite the strong opinions and diversity of views expressed at the conference, Nichols found evidence of some meeting of minds. Participants agreed that the individual market "does work for some people—but probably can never work for other people," he said. The biggest disagreement is what to do about those who are left out. Nichols concluded that the policy debate boils down to a single question: "Do you want to cover the relatively many low-risk people who could take the tax credits and buy reasonable coverage in the nongroup market without much regulation, or do you want to focus your limited public dollars on the smaller but more vulnerable high-risk population?" The answer to this question will go a long way toward determining whether policy makers prefer individual tax credits, expansion of public programs or more subsidies for the private group market as the next step toward reducing the number of uninsured.●