The Role of a Public Health Insurance Plan in a Competitive Market
Lessons from International Experience

Timothy Stoltzfus Jost

- All developed countries have both public and private health insurance plans, although private insurance usually supplements or complements public health insurance coverage and rarely competes with it directly.

- In two countries, Germany and Australia, private plans compete directly for members with the national public health insurance program.

- All Germans must have health insurance, but certain groups, including higher income households, can choose to be privately insured. Of those who can choose, about half choose private health insurance, the rest remain with the public social insurance program.

- Any Australian may also choose to purchase private health insurance for hospital care, and about 45 percent of the population does so. The government offers subsidies for those who choose private health insurance as well as penalties for higher-income households who do not.

- The largest of Australia's "private" insurers, with 29 percent market share, is a government-owned corporation, Medibank Private Ltd. Medibank Private is not subsidized by the government and functions much like the current proposed public plan.

- Experience with public-private competition in Germany and Australia, as described in the attached paper, demonstrates the following:

- Private insurance is more costly than public, pays higher provider fees, and has much higher administrative costs

- Private insurers prefer to compete based on risk selection and this cannot be eliminated completely by regulation.

- Private insurers also prefer to compete by claiming to provide preferential treatment by providers rather than on cost controls

- Private insurance coverage tends to be less transparent than public.

- Private insurance markets continue to thrive when public and private insurers compete. Public-private competition increases choice for consumers, and is consistent with the continued provision of high quality medical care.

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Perhaps the most controversial issue in the current health care reform debate is whether or not to establish a public insurance plan to compete with private plans in the market for individual (nongroup) and possibly employment-based health insurance. Advocates argue that a public plan would increase the competitiveness of the health insurance market, which is now heavily concentrated among a handful of insurers in most states.[1] A public plan alternative would also, its advocates content, bring down the cost of health insurance as the public plan would have lower administrative costs than private insurers, would not have to make a profit, and could drive a harder bargain with providers. Opponents of a public plan argue that a public plan would compete unfairly with private insurers, possibly driving them out of business, and pay providers unreasonably low prices.

One place we might look for information to resolve the question of the likely effects of a public plan is the experience of other nations. Although the popular health care reform debate often characterizes the health care systems of other nations as "single payer," there is not in fact any "single-payer" health care system in the world. Every developed country in the world finances health care through a mixture of public insurance, private insurance, and out-of-pocket expenditures.

Private insurance is found in all countries. In some countries, such as the U.K., public insurance coverage is universal, but individuals may purchase private insurance (or have it provided through their employment) to allow quicker or more convenient access to health care, essentially allowing queue jumping. In other countries, such as Canada, private insurance covers access to services not covered by the public system, such as pharmaceuticals, dental, or vision care. In some countries, like France, cost-sharing obligations in the public system are privately insured (much like our Medigap insurance). In yet other countries, higher income households are not covered by public insurance (as in Germany) or are only covered partially, as in Ireland and Australia. In these countries private insurance is purchased by higher income households either to cover all services or to cover those services not publicly insured. Ninety-two percent of the population of France is publicly insured, as is 65 percent of Canadians, 44 percent of the Irish, and 10 percent of the U.K. population.[2]

Although every country, including the United States, has some mixture of public and private insurance, there are few countries in which public and private insurers compete head to head for the same purchasers. Because private insurance usually complements or supplements

[1] In 47 states the three largest private health insurance firms control over half of the commercial health insurance market, and in 36 states they control over 65% of the market. James C. Robinson, Consolidation and the Transformation of Competition in Health Insurance, Health Affairs 23(6): 11 (2004).

[2] All 2000 figures. OECD, Private Health Insurance in OECD Countries (2004).

public insurance, competition between private and public insurance is rare. There are at least two examples of such competition, however, that offer some insight into how direct public-private competition operates.

One such example is Germany, where all residents are legally required to have health insurance as of January 1 of this year. Most are required to be publicly insured through the social insurance funds, but civil servants, the self-employed, and higher income households (currently those earning more than 4050€ per month) have the option of buying either private insurance or remaining within the social insurance program.[3] About 12 percent of the German population has chosen to be privately insured, and has opted out of the public system. In fact, however, about 15 percent of those insured through the public social insurance system in Germany are persons who could be covered under the private insurance system but choose to stay in the social insurance system. In other words, about half of those who could choose private insurance stay in the public insurance program.

Public social health insurance premiums are based on a percentage of income (up to a ceiling) and thus can be quite high for higher-income individuals. Private insurance premiums generally vary with age, sex, and medical history at time of entry, and are high for higher-risk households.[4] By law, private health insurance is funded on a level premium basis, so that younger people are charged more with part of the premium used to set aside capital reserves to cover their health care needs as they get older, and older persons are charged less than they would be if they had to carry their own weight. Health insurance is, therefore, less expensive for younger entrants than for those who delay entry, as they have more years over which to spread their total costs, but it still costs younger persons more than it would if premiums only covered current year costs.

Both private and public insurance funds compete actively for subscribers. Private insurance pays higher rates to doctors for medical care than do the social insurers (20% to 35% more), and it is commonly believed that privately-insured persons receive preferential care. Although virtually all doctors serve both private and social insurance patients, publicly insured patients have to wait longer for doctor's appointments and have to sit slightly longer in the waiting room before they are seen.[5] Private health insurers may also cover new medical technologies that are excluded from social insurance coverage because they have been determined to offer little or no incremental clinical effectiveness. The primary reasons given by those who prefer private insurance is the belief that private patients receive preferred treatment and that private insurance covers drugs and treatments that the social insurance does not cover.

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[3] Supplementary or complementary private insurance in Germany can also be purchased to cover services or expenditures that are not covered by social insurance. See Stefan Gress, Private Health Insurance in Germany: Consequences of a Dual System, http://www.pubmedcentral.nih.gov/articlerender.fcgi?artid=2645182 (2007); Stefan Gress, Competition in Health Insurance: Reflections from Germany, http://www.ans.gov.br/portal/upload/biblioteca/memoriaeventos/II%20Seminario%20Internacional_junho_08/Stefan%20Gress.pdf (2008). Polling data from http://de.statista.com

[4] Private insurers must, however, offer a "basic" policy at a reduced community-rated premium to lower income or higher risk applicants.

[5] See Markus Lungen, et al., Waiting times for elective treatment according to insurance status: A randomized empirical study in Germany, International Journal for Equity in Health 7:1 (2008).

These factors obviously add to the cost of private insurance, however.

Public social insurance is, on the other hand, more attractive to those who become eligible for private insurance later in life or when they are in poor health. Under German law, moreover, a person who opts out of public insurance cannot usually return, so the decision to move to private insurance is not lightly made, and a German eligible to switch must carefully consider whether he or she will be able to maintain coverage in retirement. The main reasons that are given for not choosing private insurance is that it is too expensive, coverage is less clear than public coverage, and that insurance may become unaffordable in retirement. One recent poll found that 22% of publicly insured Germans polled would rather be privately insured, but 58% preferred to stay with public social insurance.

German private insurers pay higher prices for health care and have higher administrative costs than the social insurers.[6] They compete with public insurers primarily on the basis of risk selection and by claiming to offer higher quality care and quicker access to care. This system has existed for decades, however, and private insurers have continued to prosper, while health care providers have continued to offer high quality care without significant rationing to both publicly and privately insured Germans.

Another model for private-public competition is that found in Australia.[7] Australia has a publicly financed system, Medicare, that covers hospital, medical, and pharmaceutical care. Australians may, however, purchase private insurance to cover hospital care (including care by physicians in hospital) and ancillary services (such as physical therapy or dental care) that are not publicly insured. Australians who purchase private insurance have 30% of their premiums paid by the government. Higher income Australians who fail to purchase private insurance also must pay an additional 1% of their income in taxes. The government also subsidizes the cost of in-hospital medical care for privately-insured patients. Although premiums for private insurance are community rated and most plans must sell insurance to anyone who applies for it, premiums rise with age for those who delay purchasing for each year beyond age 30, so there is some incentive to not wait until one is in poor health to purchase it. Private insurance is community rated and subject to a risk adjustment scheme that tries to compensate funds that take on higher risks. Nevertheless, there is some evidence of risk selection by private funds. Administrative costs are much higher in the private funds than in the public sector, and private insurance has increased the cost of the overall health care system. There have also been ongoing problems of price transparency in private health insurance markets, as doctors are permitted to balance bill

[6] Private insurance administrative costs run 15-20% of total expenditures, while social insurance administrative costs run 5-7%.

[7] See Luke Buckmaster & Jerome Davidson, The proposed sale of Medibank Private: historical, legal and policy perspectives (Parliament of Australia Research Brief, 2006); Francesca Colombo & Nicole Tapay, Private Health Insurance in Australia: A Case Study (OECD, 2003); Private Health Insurance Administrative Council, Operations of the Private Health Insurers, 2007-2008 Annual Report (2008), available at http://www.phiac.gov.au/publications/ar_registered_health/26415.pdf.; Timothy Stoltzfus Jost, Private or Public Approaches to Insuring the Uninsured, New York University Law Review 76:419 (2001).

beyond insurance payments (although they must under recent legislation inform patients of their intent to do so). The primary advantage of private insurance is that it gives access to private hospitals and faster access to elective procedures. About 45% of the Australian population is currently privately insured.

Within its private health insurance system, Australia offers perhaps the most relevant example for American health reform. The largest "private" insurer in Australia is Medibank Private Ltd., the only private insurer that is found in all Australian states and territories. Medibank Private is a government corporation. Thus Australia offers an example of a publicly-owned insurer that competes head to head with private insurers (some of which are for profit and others of which are nonprofit) without public subsidies, the model that is proposed for the United States. Medibank exists for historical reasons–it is what survives of an attempt to create a universal public system in the 1974 after that system was abandoned with the election of a new more conservative in favor of a predominantly private system two years later.[8] When the public Medicare system was introduced in 1984, the private system, and with it Medibank Private, was preserved as an alternative for funding hospital services.

Although Medibank is currently the largest private insurer in Australia, it controls only about 29% of the market. Its market share has varied from year to year. Its prices are competitive with those of other insurers, but it is considered by some to be a market leader in holding down premiums. It also has consistently had administrative costs slightly below the average of other insurers. It has, according to some commentators, served as a social conscience for the private insurance industry, supporting a complementary role for private insurance and community rating. It is also believed that its existence has discouraged collusion among private insurers. Attempts to privatize it in recent years have been successfully resisted by those who believe that there are advantages to having a public plan in the private market. The Australian experience demonstrates that it is possible to have a public plan that runs efficiently, pays providers competitive rates, and competes successfully with private insurers without driving them out of the market.

What lessons can we learn from the experience of other countries with public/private health insurance competition? First, we learn what we already know from our own experience, particularly with Medicare Advantage plans: private insurance inherently costs more than public insurance. This is logically inescapable. Private insurers must usually (depending on the nature of the regulatory regime) spend money on marketing, underwriting, and reserve costs, as well as make a profit if they are for-profit, all costs that can be avoided by a private plan. Second, private insurers generally prefer to compete based on risk selection rather than by holding down their costs. It is a well known fact that the costs of health care are heavily skewed—in any given year 1% of the population accounts for over a quarter of health care costs, 5% for over half. An insurer can gain much more by simply capturing a low risk applicant or avoiding a high risk applicant than by controlling costs. Risk selection is better controlled in some countries than in others, but it is very difficult to eliminate it entirely from private markets. Public insurers have

[8] Sidney Sax, A Strife of Interests: Politics and policies in Australian health services (Sydney: George Allen & Unwin, 1984).

less reason to risk select, and thus are more likely to end up with higher risks. They have to control costs in other ways, such as holding down administrative costs or payments to providers. Third, when private insurers and public insurers compete, private insurers compete primarily through claiming to offer more rapid access to care, more attentive care, and care from providers with better reputations. They are less likely to compete on the basis of price. Public plans can offer a lower price product to those who are more focused on the cost of care. Fourth, coverage under private insurance plans tends to be less transparent than under public insurance. Finally, and perhaps most important in terms of the current debate, competition among private and public providers neither drives private plans nor private providers out of the market. Public-private competition is consistent with a thriving private insurance market and with the provision of high quality care in both public and private markets.