

Sorting on Risk in a Market with ESI Groups & Individual Private Insurance

High Risk, High Cost

Medicare

Medicaid

Employer-based Groups

Involuntarily Uninsured

Moderate Risk, Moderate Cost

Private Insurance

Employer-based Groups

Voluntarily & Involuntarily Uninsured

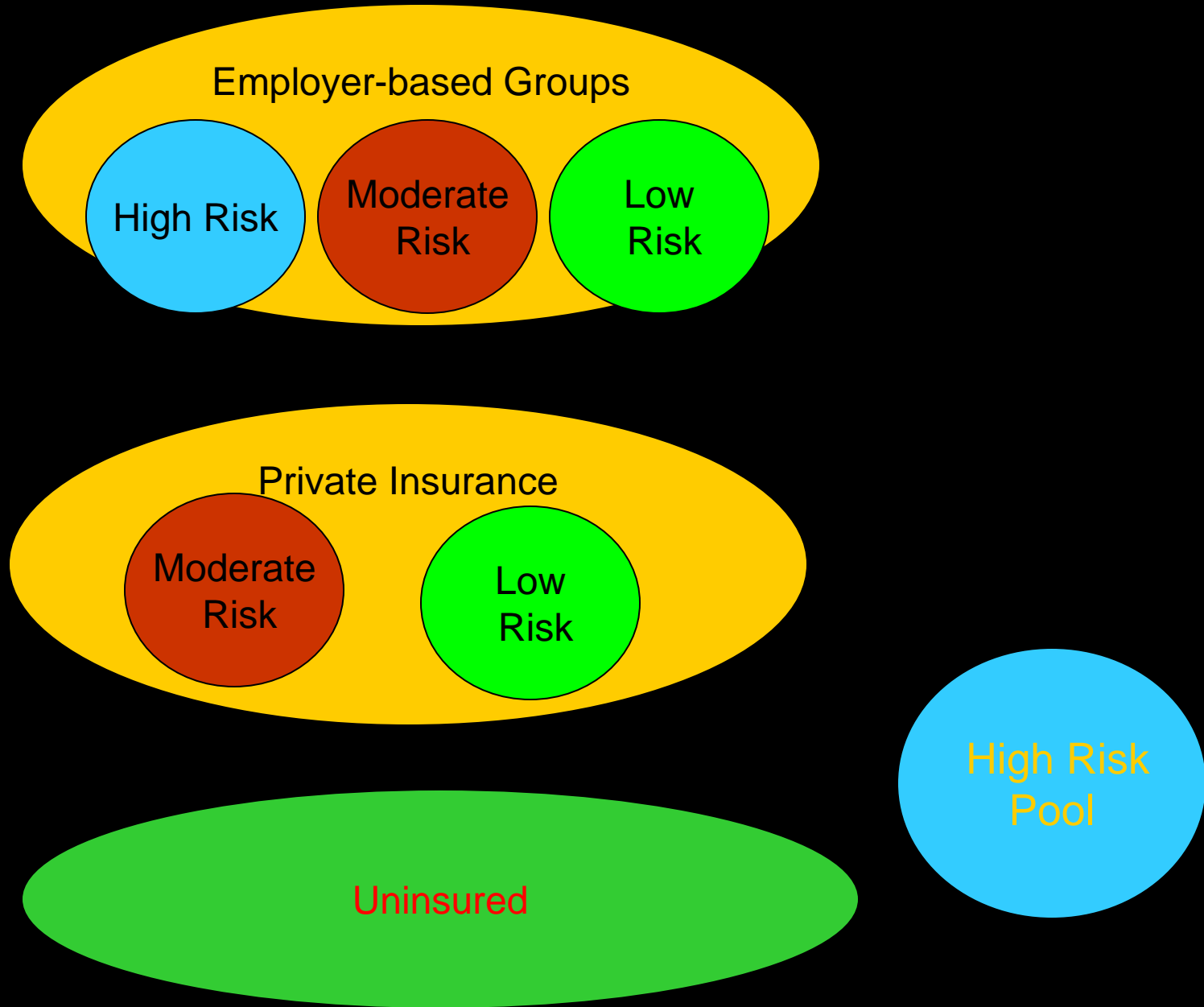
Low Risk, Low Cost

Private Insurance

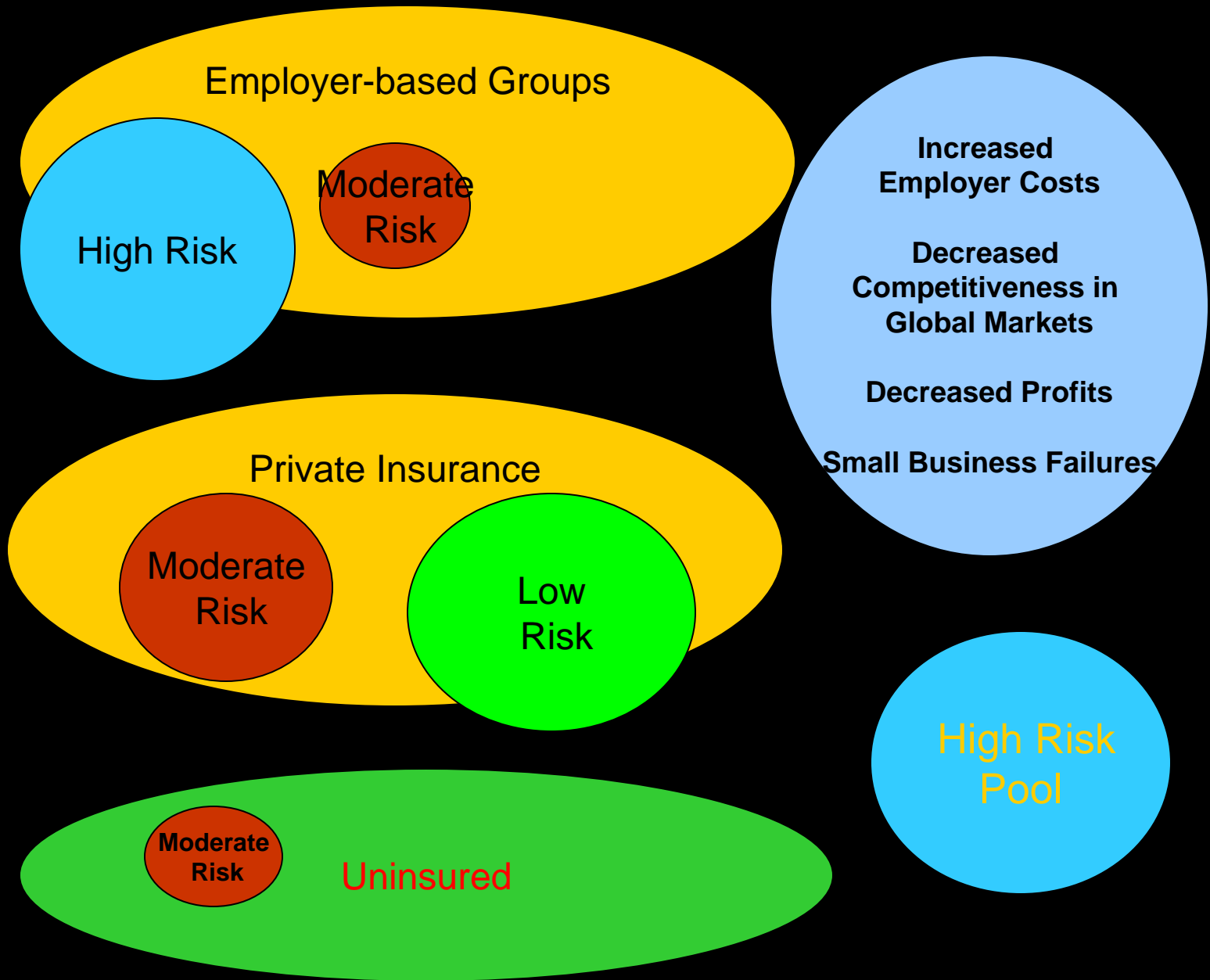
Employer-Based Groups

Voluntarily Uninsured

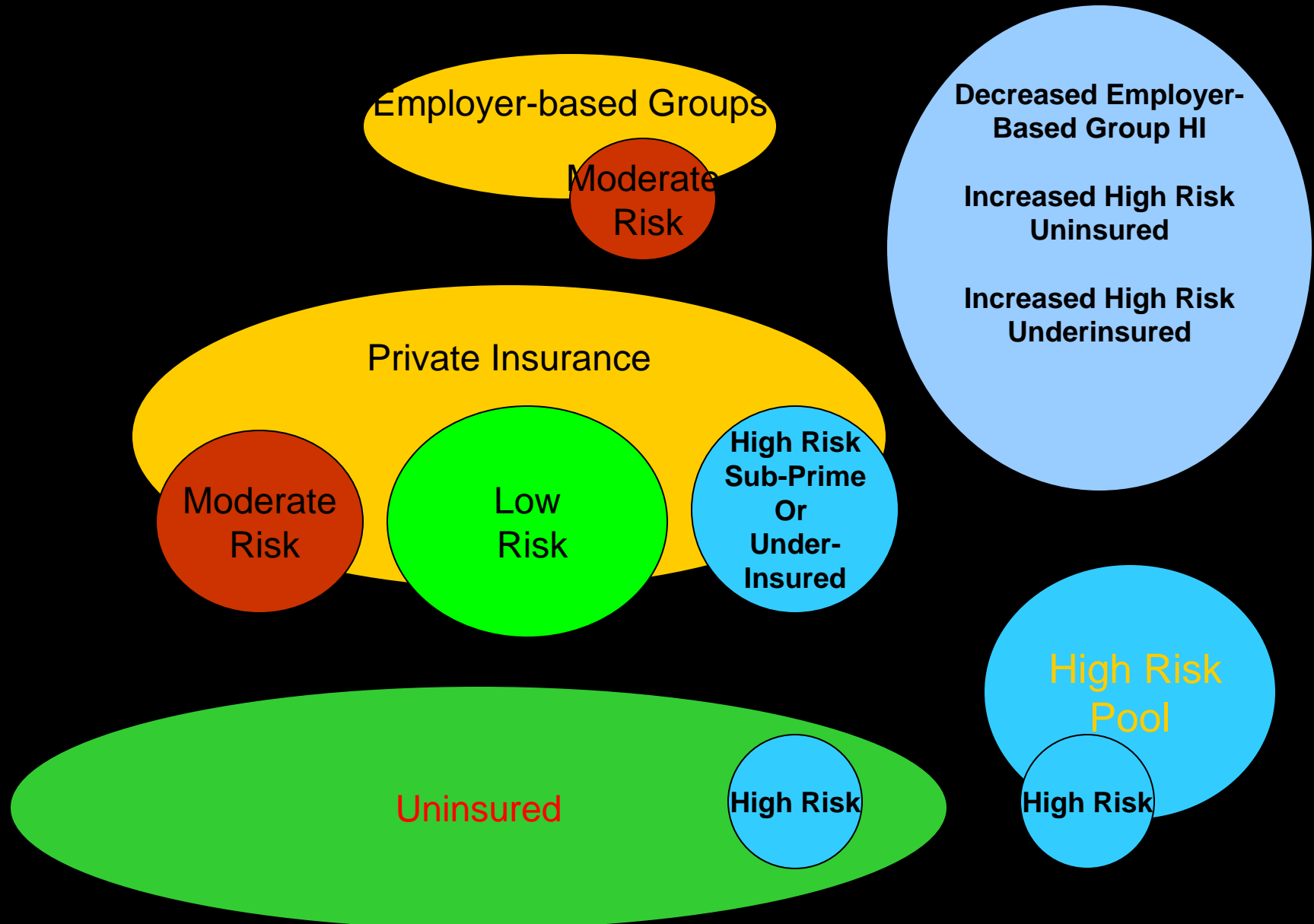
Private Health Insurance: Sorting on Risk (JSM)



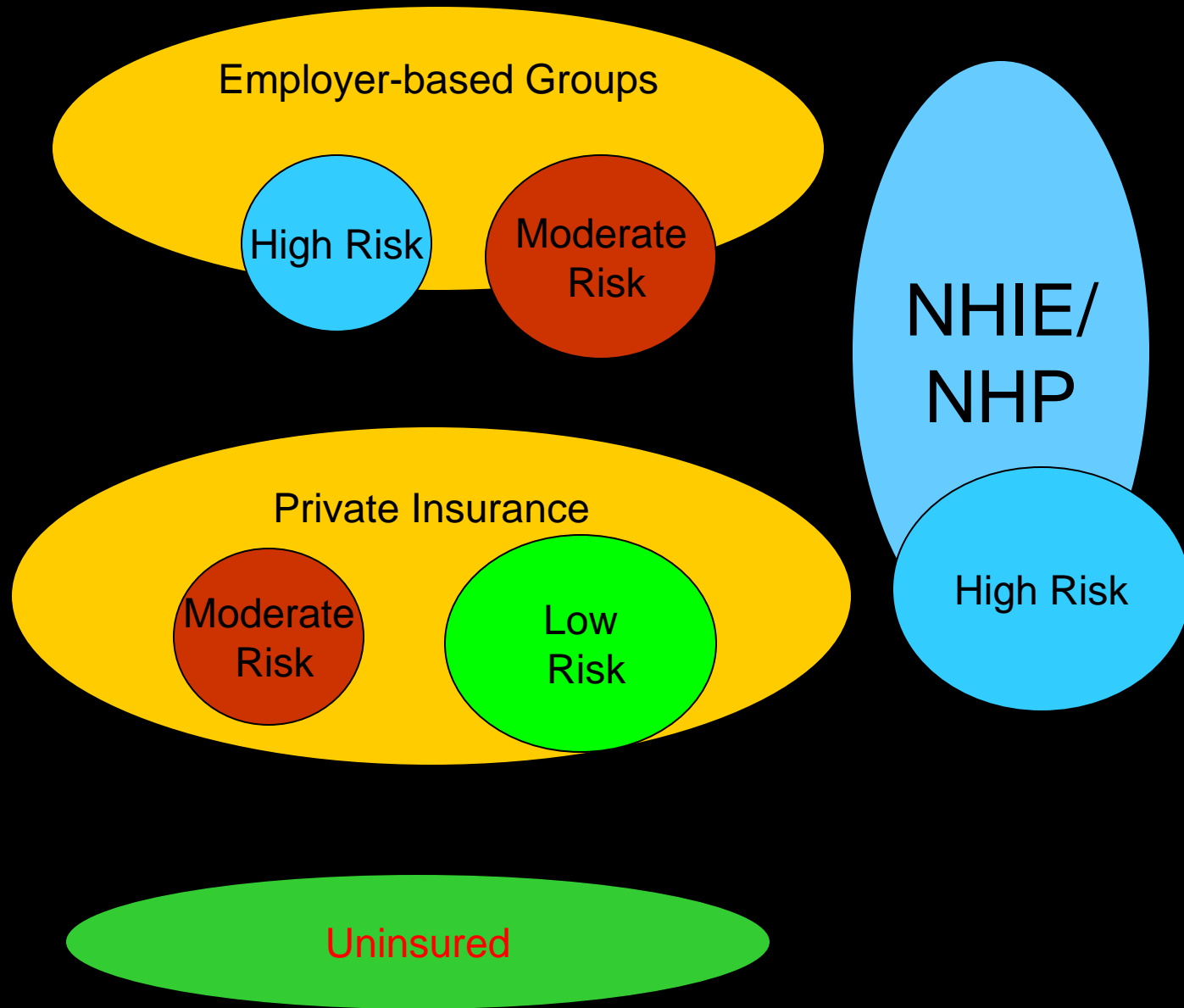
Private Health Insurance: Sorting on Risk (JSM)



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Private Health Insurance: Sorting on Risk (BHO)



The Market for Sub-Prime Health Insurance

Uninsured

**Voluntarily Uninsured
(Young, Healthy)**

**Uninsured Who Would
Like to Be Insured But Can't Afford
A Comprehensive Policy
(Pre-existing Conditions,
Chronically Ill Children, etc)**

Sub-Prime HI Market

Likely Sub-Prime Health Insurance “Choices”

- High Deductible (\$1,000+)
 - Inhibits seeking treatment earlier when subsequent costs are likely to be lower
- Low maximum annual benefits
 - \$5,000-\$25,000
 - Not enough to cover more than simple outpatient surgery
- Little or no preventive screening

Who Is the Payer of Last Resort for
Individuals in Private HI Market Who Exceed
Their Max Annual Benefits?

Taxpayers

Privately Insured Through Higher Prices
& Premiums

Health insurance markets are not competitive because of risk uncertainty, moral hazard, adverse selection, information asymmetry, and agency problems.

It may be nearly impossible to make them competitive because of the financial incentives for insurers to sort on risk.

The current US approach to health insurance helps the private HI market to be profitable by transferring risk and costs to taxpayers.

Taxpayers insure through Medicare, Medicaid, and higher prices most of the high risks not covered by EPHI

The Obama Plan is likely to reduce the number of uninsured in the US because the publicly financed National Health Plan serves as an insurer of last resort for the high-risk uninsured.

The McCain Plan will stimulate innovation in the sub-prime health insurance market resulting in suboptimal risk management of this high risk population. It is likely to indirectly transfer that risk and its costs to taxpayers who will pick up the health care costs of high risk patients who exceed the annual benefit limits of sub-prime insurance policies.