

Commentary

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Giving Insurers More Room to Operate Would Increase Beneficial Competition

By Rik W. Hafer

In this limited space, it is impossible to deal with all of the issues, real and imagined, that currently swirl around the health care debate. As President Barack Obama learned, it also is impossible to meaningfully reform the industry without substantial debate and fact checking.

Summary

Advocates of a nationwide public option for health insurance claim the plan would increase competition. Before layering the market with new bureaucracy, however, it's important to consider how regulatory barriers already hamper competition in health insurance markets. Removing barriers is much more efficient than creating new ones.

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Because I am not an expert in this field, I sought opinions and insights by asking the following question to a list-serve for economists: Is there any evidence that the current health insurance market is non-competitive?

I asked this question, which seems fairly relevant to the current discussion, because of recent claims that consumers face few choices when it comes to buying health insurance. Here's a sample of what I learned.

First, it is not true that there is no competition. As reported in the *New York Times*, the evidence on insurance competition is mixed. Health insurance in nine states is dominated by a single company. For example, in Alabama one company provides 83 percent of the health insurance coverage.

A notable characteristic of these nine states is that they tend to have small populations. Add together the populations of three of them — Maine, Montana, and Wyoming — and you get 2.7 million, or the population of the Saint Louis metro area. With such small and dispersed populations, it makes sense that only with a single provider can they achieve the scale economies necessary to provide coverage.

What about the other 41 states? In three of the most populous states (California, Florida, and New York) the dominant company covers at most 30 percent of the population. In other states, single-firm dominance is less than 50 percent. In addition, it appears that in the largest metropolitan areas, multiple companies provide coverage. In other words, there is competition.

Second, if competition is lacking, why? Trade barriers. Most consumers cannot buy insurance out of state. This restriction came

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about in 1945 when Congress passed the McCarran-Ferguson Act in response to states' concerns that they had lost authority to regulate the insurance industry following the Supreme Court's ruling in *United States vs. South-Eastern Underwriters*. Politics and protection of regulatory turf trumped good economics.

Third, market imperfections (exacerbated by government interference) often lead to bloated costs. A study issued by the Commonwealth Fund in July 2009 reported that private insurance administrative costs represented about 12 percent of spending on health services and supplies. This is larger than, say, the administrative costs of government-run programs, such as Medicare. Hence, the notion that adding a government option would increase competition and lower the cost of providing insurance to more individuals.

As I was reminded by one colleague, the charge that private insurance administrative costs are comparatively high reflects the fact that administration is about all insurers do. Private companies administer claims and provide policy oversight for a vast number of employers who self-insure. Instead of layering on a Medicare-like bureaucracy, why not explore the effect that dropping of cross-border barriers might have on lowering the cost of providing coverage?

Fourth, health care providers use the availability of Medicare fee schedules to set reimbursement rates to health care providers. That is, private insurance companies tacitly collude with the government to reduce their reimbursements to that established by Medicare. If Medicare decides that it will pay your ophthalmologist \$100 for that new cataract lens when the provider's cost-covering price is \$150, the private insurer will follow Medicare. Health care providers may thus be faced with a "this or nothing" scenario. Price ceilings below the market-determined price, in the end, simply reduce availability of options.

Before overhauling the current system and imposing more government mandates, here's a modest proposal: Let's consider whether reducing the government's interference would increase competition in the health care industry.

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