



Consumers' misunderstanding of health insurance



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ABSTRACT

We report results from two surveys of representative samples of Americans with private health insurance. The first examines how well Americans understand, and believe they understand, traditional health insurance coverage. The second examines whether those insured under a simplified all-copay insurance plan will be more likely to engage in cost-reducing behaviors relative to those insured under a traditional plan with deductibles and coinsurance, and measures consumer preferences between the two plans. The surveys provide strong evidence that consumers do not understand traditional plans and would better understand a simplified plan, but weaker evidence that a simplified plan would have strong appeal to consumers or change their healthcare choices.

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1. Introduction

Beginning in Fall 2013, as part of the 2010 Affordable Care Act (ACA), the Federal government and the minority of states who have opted to do so will begin open enrollment for a new set of ‘affordable insurance exchanges’. The website HealthCare.gov describes an affordable insurance exchange as a “new transparent and competitive insurance marketplace where individuals and small businesses can buy affordable and qualified health benefit plans.” The linking of the words “competitive” and “affordable” in the description reflects the stated intention of the designers of the ACA that competition between insurance companies will lower prices while maintaining quality.

In thinking about competition in the insurance market, one can distinguish between two levels at which it occurs. At a higher level, insurers compete with one another to attract business from employers (or possibly exchanges) – i.e., to include their plans among those offered to employees (or exchange subscribers). At a lower level, once a plan has been selected for inclusion by an employer or exchange, insurers will compete to attract subscribers to their plan as opposed to other plans being offered. Although our main focus in this paper is at the lower level – on employees understanding of, attitudes toward, and behaviors contingent upon different insurance plans – ideally competition at both of these levels will have beneficial effects on price and quality.

Competition at the consumer level, however, is only likely to result in reduced prices and improved quality when sufficient numbers of consumers make informed decisions. As Gabaix and Laibson (2006) show (see, more recently, Heidhues et al., 2012a,b), competition can fail to eliminate biases in markets if there exists a core of consumers who make systematic errors in choosing between products. Given a significant core of naïve consumers, they show, a market equilibrium can arise in which naïve consumers pay prices substantially above marginal cost, and effectively subsidize sophisticated consumers who are able to exploit the mispricing. In the domain of insurance, for example, the existence of a substantial core of consumers who are disproportionately attracted to low deductible policies (see, e.g., Barseghyan et al., 2013; Sydnor, 2010) can enhance insurer’s profits at the expense of those opting for low deductibles, while those who opt for high deductibles escape to fairly priced plans.

Whether consumers make self-interested or self-destructive decisions is not only a function of their individual levels of sophistication, but also of market-level factors. Research has shown, for example, that consumers can be overwhelmed and make worse decisions when they are given too much choice (Cronqvist and Thaler, 2004; Iyengar and Lepper, 2000). In the domain of insurance, consumers faced with too many choice options, particularly if not pre-screened for price and quality by an agent such as an employer, are likely to engage in suboptimal decision strategies, such as sticking with existing insurers or deciding based on word of mouth, and competition can suffer as a result. One study of Medicare plans in a Boston suburb, in which consumers chose between 47 different Part D prescription plans, found that the most expensive of the highly rated plans charged a premium 2.4 times that of the least expensive plan (Frank and Zeckhauser, 2009). Sensibly, most private employers who offer employees multiple insurance options not only prescreen plans but typically only offer a small number (e.g., 3–6).

Consumers can also make suboptimal decisions when faced with choices that are overly complex. Recognizing the importance of simplicity, the ACA mandates that, by March 2013, all insurers and employers will be required to present information about insurance plans in a standardized “summary of benefits and coverage” document that describes plan features such as premiums,

deductibles and co-insurance. The law also eliminates the proverbial ‘fine print’ in a somewhat literal fashion by mandating a minimum 12-point type size. In addition, insurance shoppers will be given standardized cost estimates, modeled after nutrition facts labels on food products, for three common medical conditions: maternity care, breast cancer and diabetes. These provisions seek to mitigate a widely perceived but poorly documented problem: people’s lack of understanding of their health insurance.

Despite frequent lamentations about Americans’ poor understanding of health insurance, there is only limited empirical research addressing the issue. A recent posting on the website of Consumers Union lamented that “the field of health literacy, while quite robust in other ways, does not precisely measure consumers’ ability to understand and use health insurance.” (Consumers Union et al., 2011). The same posting notes that a comprehensive survey of health literacy research includes not a single study that investigates consumers’ ability to understand and use health insurance (Berkman et al., 2011).

We address this gap in existing empirical research by reporting results from two different surveys designed to address the two issues raised by Consumer’s Union: consumers’ ability to (1) understand and (2) use health insurance. The first, ‘comprehension’, survey addresses not only how well Americans understand their own health insurance coverage, but also how well they believe they understand it. Prior research (e.g., O’Donoghue and Rabin, 2009) has shown that whether consumers have insights into their own decision errors can be as consequential as whether they are subject to the errors in the first place, in part because those who are aware of being prone to errors can take self-protective measures, such as hiring experts or employing decision aids.

The second, ‘choice’ survey, addresses consumers’ ability to use information about health insurance and specifically examines whether they would make better decisions if they had a better understanding of their insurance plan. Drawing on insights from the comprehension survey regarding which features of health insurance consumers find difficult to understand, we devised a simplified health insurance policy that eliminated the features of health insurance that consumers find most confusing: deductibles and coinsurance. Instructing respondents to imagine that they were either insured under this simplified plan, or under an actuarially equivalent traditional plan, the choice survey then asked them to make a series of hypothetical health care decisions. These choices were specifically designed to assess whether those insured under the simplified insurance plan would be more likely to engage in cost-reducing behaviors, such as going to an urgent care center rather than the emergency room for a non-life-threatening medical problem. The survey also assesses consumer preferences between a traditional plan and a simplified all-copay medical insurance plan.

2. Prior research

Prior studies of individuals’ understanding of health insurance coverage have adopted a wide range of methods, but have generally reached a common conclusion: people’s understanding of health insurance is far from perfect.

In one broad line of research, people with health insurance have been asked to report on – i.e., have effectively been tested on – relatively crude aspects of their own coverage. One study surveyed a mixed sample of individuals in different regions of the U.S., some of who were participating in a health insurance experiment and others who were insured but not participating in the experiment. The survey revealed that 90% of respondents with health insurance coverage were aware of being covered, were relatively well informed about their coverage of in-patient services, but

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