National Center for Policy Analysis

**BRIEF ANALYSIS**
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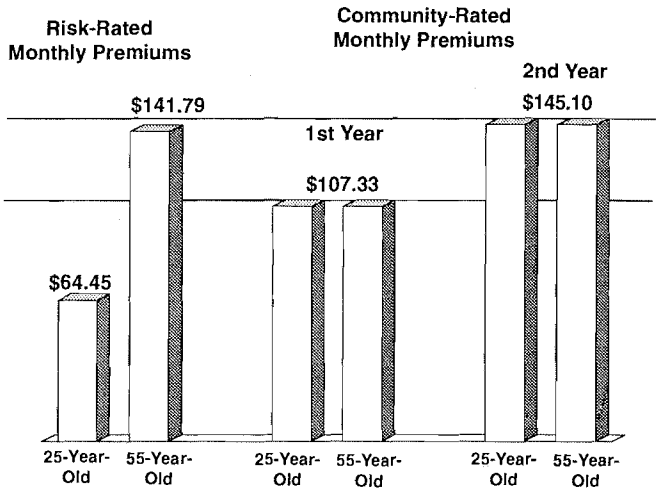
# Community Rating
# A Cure Worse Than the Disease

Under "community rating" health insurers are required to charge the same premium to every policyholder, regardless of their expected health care costs. Under "modified" community rating, premiums may be adjusted by age and sex. Both types of regulation allow people who are already sick to purchase health insurance for the same price as those who are healthy. Thus:

- A person who has AIDS would be able to purchase health insurance for the same premium as someone who does not.
- People in hospital cancer wards would be able to purchase insurance for the same premium as people who do not have cancer.

Community rating is part of the Clinton administration's health care reform package. It is also present in a number of other reform proposals. Is it a good idea? Let's take a closer look.

**The New York Experience**




**Community Rating Would Increase the Costs of Health Insurance for Most People.** In order to achieve a level premium for everyone, healthy people must be charged more so that sick people can be charged less. And, because most people are healthy, most people would eventually see their premiums rise. In 1993, the state of New York implemented legislation requiring insurers to (1) accept all applicants regardless of health status and (2) charge everyone the same premium for health insurance. According to the New York Department of Insurance:

- In the first year of community rating, almost 30 percent of the insured experienced premium increases ranging from 20 to 59 percent.
- Rates for a 30-year-old single male increased by 170 percent.

Consider the experience of Mutual of Omaha, the only major company besides Blue Cross selling individual policies in the state. Nationally, Mutual's claims (medical expenses paid under its policies) averaged about $3,800 per family last year, an increase of only $400 from 1992. But under community rating in New York, its average claim more than doubled, rising to $7,900. These increased claims resulted in a 35 percent increase in premiums, on top of a huge increase already adopted when community rating was implemented.

**Community Rating Would Increase the Number of Uninsured.** The intent of the New York law was to increase the number of insured by raising the premiums of the healthy in order to subsidize the premiums of those at high risk. The result: as sick people entered the market, causing costs (and, therefore premiums) to rise, healthy people left. According to the New York Insurance Department, 43,666 individual policyholders have canceled their policies. Those moving out of the health insurance market are the younger, healthier segment of the population. Mutual of Omaha reports that under the new law the average age of its New York policyholders has increased by 3.5 years.

**Community Rating Would Redistribute Income from the Poor to the Rich.** Because community rating increases premiums for younger people and decreases them for older people, it results in a regressive system that penalizes those who can least afford to pay higher premiums. For example, nationwide the median annual

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income for a worker age 25 or under is $18,313, while for a worker age 45 to 54 it is $43,751. And persons under age 35 have less than half the assets of any other age group. Thus, it is obvious that community rating transfers money from those who have less to those who have more.

Health economists David Bradford and Derrick Max have analyzed the distribution of expected medical expenses under the community-rated Clinton plan and have concluded that:

- Although the average cost of health insurance (the community-rated premium) under the Clinton plan is predicted to be about $2,000 in 1994, the cost of insurance would be $1,350 for people ages 25 to 29 and $4,000 for people 60 to 64.
- Community rating under the Clinton plan would overcharge young people by about $650 per year and subsidize older people by about $2,000.
- The Clinton plan would tax people ages 25 to 43 about $26 billion a year in order to help provide an annual subsidy of about $33 billion to those 55 to 64.

**Community Rating Hurts Those It Is Designed to Help.** Before community rating was instituted in New York, Mutual of Omaha charged a 25-year-old male in Albany $64.45 a month for health insurance. A 55-year-old paid $141.79. After community rating, both paid $107.33, a 60 percent increase for the 25-year-old and a 32 percent decrease for the 55-year-old. This year, because of higher costs, both will pay $145.10 — more than the 55-year-old was paying *before* community rating was implemented. [See the figure.] Thus, even those who are initially helped by the program are made worse off as cost increases push up premiums.

**Community Rating Would Subsidize Unhealthy Lifestyles.** When insurance premiums are determined in competitive markets, higher-risk individuals face higher premiums. People who engage in risky behavior must bear the financial burden of that risk or change their behavior. By contrast, community rating shifts most of the financial burden of some people's risky behavior to everyone else. This practice rewards risky behavior and penalizes healthy behavior.

**Community Rating Would Hurt Small Business.** Community rating across industries — as is required by the Clinton plan — would hurt those industries that currently have low health care costs in order to subsidize industries that have high costs. As a result, the job-creating small business sector would suffer. One study that calculated the effects of community rating and employer mandates concluded that:

- The Clinton plan would reduce health costs by $1,050 per worker in manufacturing and $1,728 in mining.
- By contrast, the plan would increase costs by $1,303 per worker in retail trade and $697 in the service sector.

***After one year of community rating in New York, 43,666 people canceled their policies.***

**President Clinton's Version of Community Rating Would Shift Costs from Government to the Private Sector.** Under the Clinton plan, the government would be able to enroll Medicaid patients, early retirees and the nonworking uninsured in private health insurance plans. But because of community rating, the premium for these three groups would be about half of the expected health care costs. As a result, a multibillion-dollar burden would be shifted from Medicaid and other government programs to the private sector.

The greatest problem in health care reform is making sure that, in solving the problems of the few, politicians don't create even greater problems for the many. Community rating fails that test. Its costs would greatly exceed its benefits.

**Recommended Reading:** Tony Hammond, "The Facts on Community Rating;" Health Insurance Association of America, May 1994; American Academy of Acturaries, "An Analysis of Mandated Community Rating," March 22, 1993.