

# Assessment 3



23708 Studio 1: Foundation - Spring 2024

## Private Health Insurance



Somesh  
Shanbhag

25525837



## Table of Contents

S. No	Topic	Page Number
1	Executive Summary	3
2	Introduction	4
3	Investigation of PHI Market Decline	5
4	Critical Policy Analysis	9
5	Conclusion	16
6	References	17

## Executive Summary

Australia's private health insurance (PHI) market faces significant challenges amid shifting demographics, rising premiums and declining younger enrollees. Data from APRA indicated that the sector has seen a steady rise in claims and premium costs, impacting affordability and accessibility for many, particularly young people who are essential for balancing the risk pool due to their lower healthcare costs. However the younger generation have been opting out leading to an aging PHI population that increases the financial pressure on insurers thereby potentially driving premiums even higher in a cyclical effect.

To address these issues three targeted policy interventions are under consideration. First the introduction of financial incentives such as premiums discounts or government backed subsidies for younger people which could improve younger enrollees and reduce overall risk and stabilize premiums. Second a reformed coverage structure which levy a surcharge penalty on income tax to convince those who make decent money to use PHI over public health services. This policy would help reduce the burden on public hospitals while also increasing the pool of healthy candidates thereby reducing the overall premiums for everyone. Lastly, reducing the cost of medical equipment and allowing this cost benefit to pass on to the customers will attract more younger population which will improve the pool of less risky candidates and reducing the overall premiums.

A combination of Policy 1 and Policy 3 appears to be the most effective strategy to address the decline in the private health insurance (PHI) industry. This approach offers a balanced solution that can revitalize the sector while avoiding the potential negative impacts on middle-income earners associated with Policy 2. By implementing Policies 1 and 3 together the industry can receive targeted support and incentives that are more likely to stabilize and encourage broader participation from young people without burdening middle-income households.

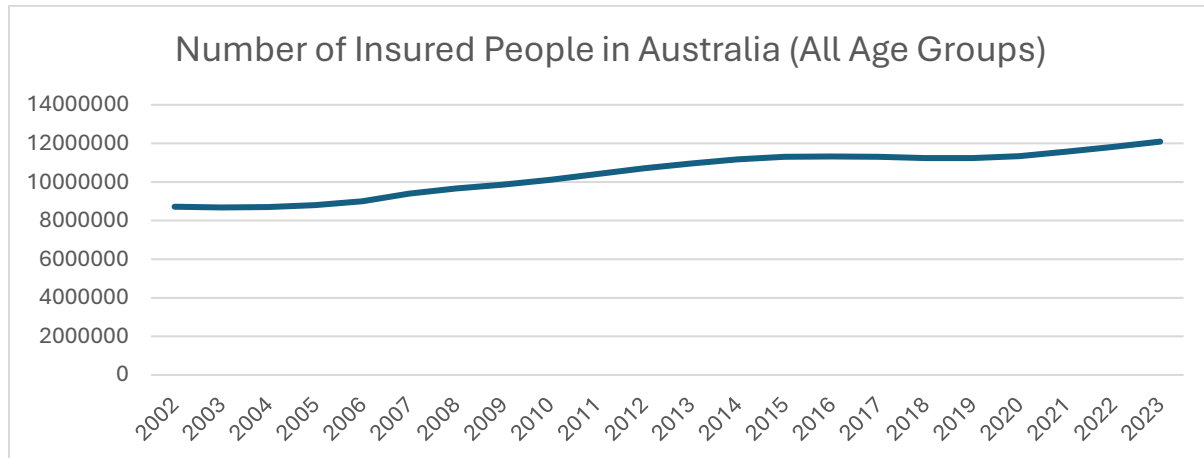
## Introduction

The fundamental nature of demand for insurance is that it is driven by the fear of the unknown. Buying an insurance is akin to hedging your bets against the risks of a bad outcome. Simply explained, purchasing insurance means forfeiting income in good times to get money in the bad times. In Australia, all Australians and permanent residents are entitled to Medicare which provides public health insurance that is heavily subsidized. However, it is also possible to buy private health insurance, benefits of which are services such as dental and priority service being covered among other things.

However, there is a fundamental way that the insurance industry functions is flawed and is said to always be in a “death spiral” without external intervention. The reason for this is that rising premiums drives away healthy customers, leaving only high-risk policy holders, leading to further increase in premiums and more healthy people dropping out. This usually leads to a decline over time which without any external support is what is referred to as a death spiral.

## Investigation of PHI Market Decline

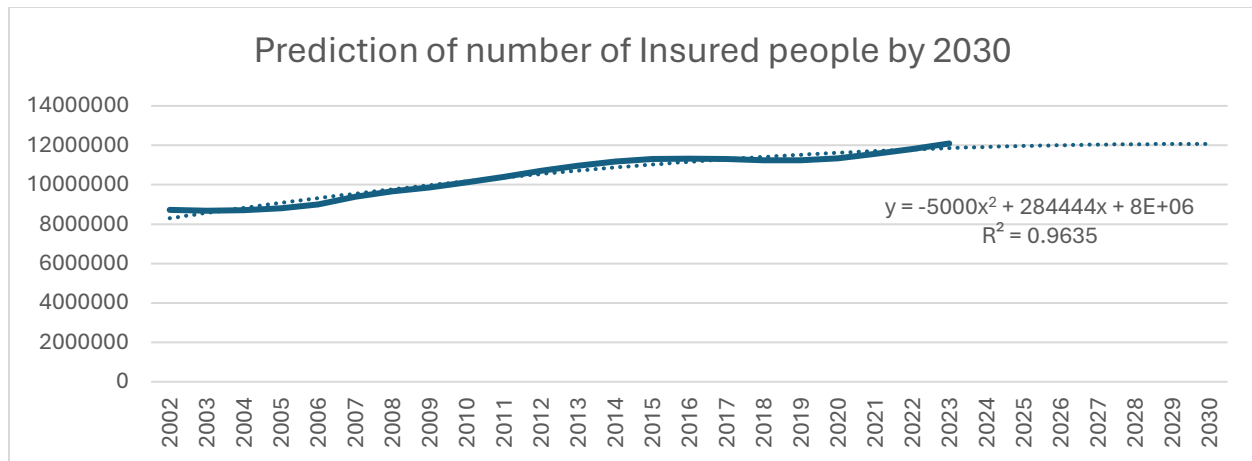
In order to assess whether the Private health insurance market in Australia is declining or not, we need to first understand the overall picture with regards to the number of insured people per population which we can see below.



*Fig.1: Graph depicting number of insured people In Australia for all age groups*

The graph illustrates a significant growth trend in the number of insured individuals over time. Although this growth seemed to stabilize and even decline by 2018, the onset of the COVID-19 pandemic led to a renewed surge in memberships. This was driven by heightened anxiety about the future and increased concerns regarding health. Interestingly, even in the post-pandemic period, the uncertainty about the future remains high, prompting more individuals to invest in their health by opting for private health insurance. Consequently, the trend reflects a continuous increase in the number of people choosing private health insurance.

Assuming all other factors constant, If we will try to predict the number of people taking PHI by 2030, we would see the following: -

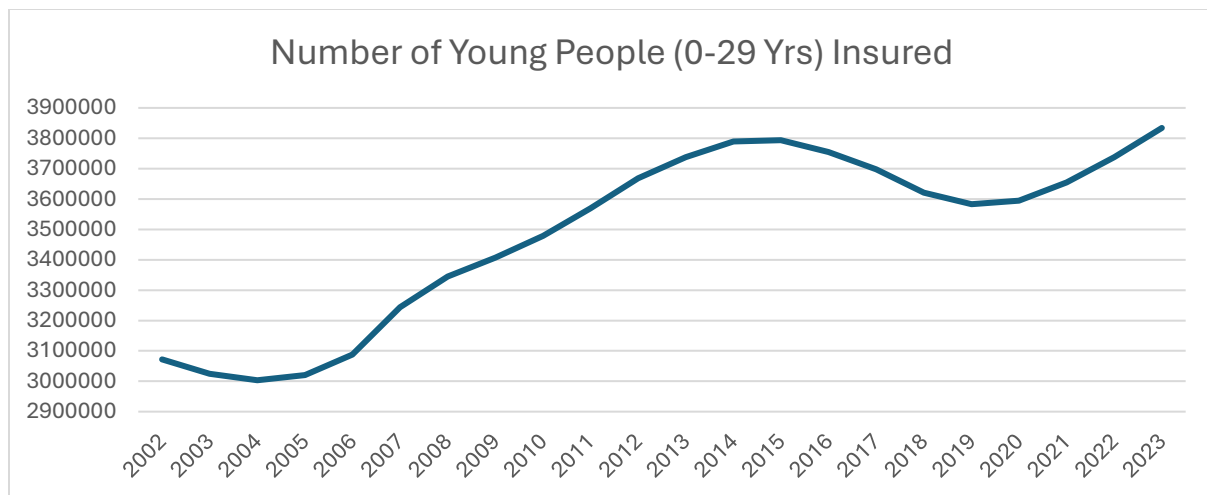


*Fig.2: Graph depicting prediction of number of insured people by 2030*

From the graph, R. Sq. value is quite high at 96.35, meaning the graph is able to quite accurately explain the behavior of various data points, which is why keeping all else constant, it is safe to say that it's quite clear that the number of people taking PHI will increase and stabilize by 2030.

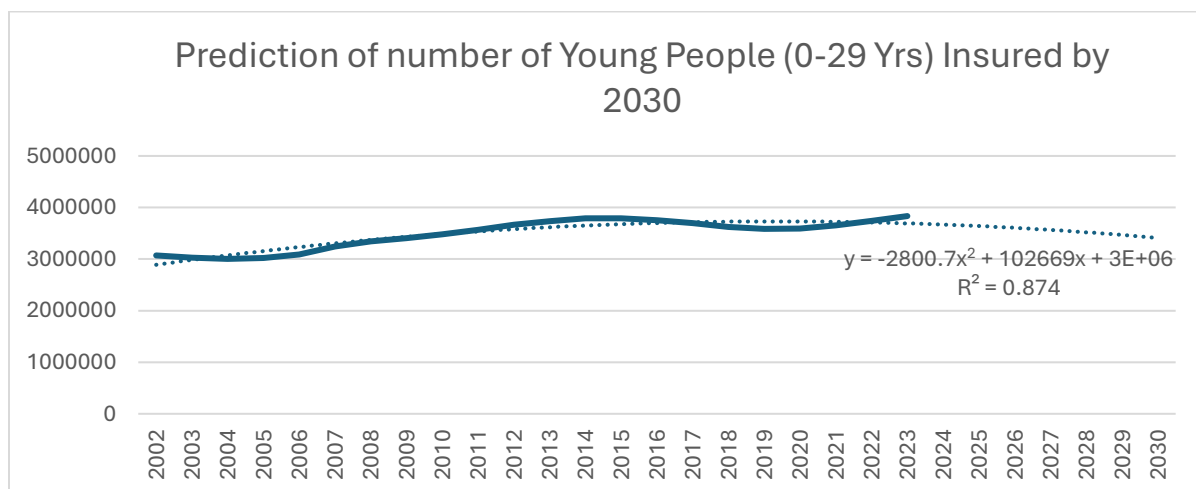
However, this does not mean that the PHI market is not in decline. The reason for this is that while there are more people taking PHI, the percentage of riskier participants may also steadily be growing compared to the non-risky participants leading to an increase in premiums, which is how such PHI markets go into a death spiral.

Therefore, we need to understand what percentage of the younger population in Australia, typically within the range of 0-29 years of age, has private health insurance. The reason for this relates back to the logic of the death spiral, if more non-risk participants are taking part in the insurance market, then everyone is paying lower premiums and have a guarantee of insurance when they really don't have the money but need it.



*Fig.3: Graph depicting number of young people (0-29 Years) In Australia*

From the graph, We can see that the number of insured young people is rising. However, there are a few fundamental issues with this. First issue is that, it is very clear that there was a drop in number of young people insured pre-covid and this would have continued to fall if the pandemic did not happen. We see a major increase in membership amongst youngsters taken predominantly to allay concerns regarding health and ability to get doctor appointments during the pandemic. Second issue is this graph is magnified to clearly express the fall in membership amongst youngster pre-covid as the . In order, to get a better understanding and predict what this membership status will look like by 2030, The graph is as follows :-



*Fig.4: Graph depicting prediction of number of young people (0-29 Years) by 2030*

With an accuracy of 87.4%, the graphs shows that keeping all things constant, the fear for health and service will stabilize and the number of insured young people will begin to drop again and will be lower by 2030 which is why it is clear that the PHI market is definitely going to decline over the next few years.

To corroborate these findings, we track the overall profits of private health insurance companies and compare the current year with last year, we can already see a significant drop in profit over time, which clearly shows that the profits peaked by 31-03-24 and have dropped significantly which can be attributed to an increase in number of riskier participants leading to more claims and hence decreased profits.

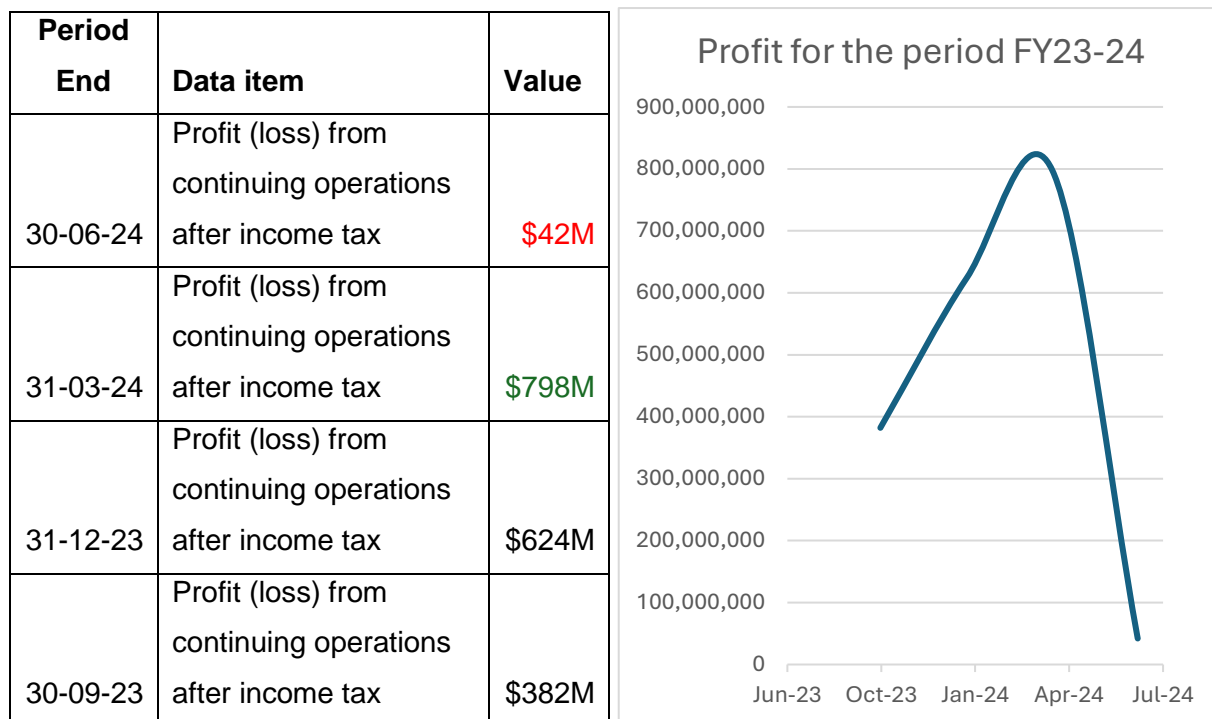


Table 1: Profit after tax for private insurance companies for FY 23 - 24

Therefore, taking all this evidence into consideration, it is clear that the Private Health Insurance Market in Australia is starting to decline.

## Critical Policy Analysis

### Policy 1

#### **Policy Description**

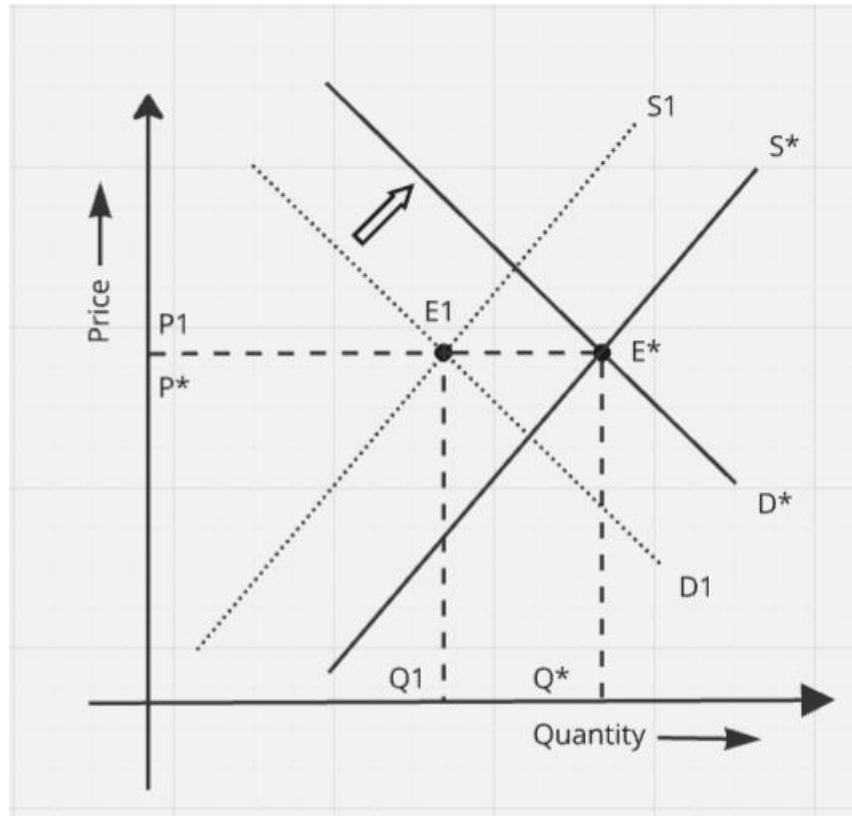
- Provide a new subsidy to insurers for every policy they sell. The subsidy will be decreasing with age (i.e., the subsidy will be higher for younger people and lower for older people).

This Policy aims to directly reduce the cost of PHI policies by offering insurers a subsidy for each policy sold. Since the subsidy is higher for younger individuals the subsidy

#### **Expected Effect on Market Dynamics**

The subsidy will make PHI more affordable for younger consumers, who are often the most price sensitive. By reducing the effective premium cost for younger individuals, this subsidy could encourage more young people to purchase PHI, shifting the demand curve to the right.

With increased demand, a new equilibrium with a higher quantity of policy sold ( $Q^*$ ) at a stable price, if insurers do not adjust the premium pricing. With subsidies covering part of the cost, premiums could be stabilized thereby potentially attracting even more young healthy people.



*Fig. 5: Market Equilibrium change through Demand*

### **Economic Reasoning**

Young people are often less likely to buy PHI due to lower perceived health risks and higher price sensitivity. This subsidy aims to offset this by directly lowering the cost barrier for them counteracting the death spiral by keeping the premiums more stable. With respect to elasticity considerations, since younger individuals are generally more price-sensitive (higher price elasticity of demand), the subsidy is likely to have a very strong impact on this demographic and encourage them to buy PHI solving the main problem of retaining healthy individuals in the pool thus balancing risks and stabilizing premiums.

### **Winners and Losers**

Young consumers benefit most from the subsidy as their effective cost for PHI decreases. Insurers gain from increased pool of policyholders which improves risk diversification and

market sustainability. The public health care system benefits as well as it experiences reduced demand if more people opt for private coverage.

On the other hand, older customers receive a smaller subsidy which may not provide as strong an incentive to switch or to stay with PHI. They may perceive this policy as less beneficial or equitable.

## Policy 2

### Policy Description

- Lower the threshold for the 1% Medicare levy surcharge – a tax penalty for people without private cover – from \$93,000 to \$50,000 for singles and from \$186,000 to \$100,000 for couples/families.

Lowering the income threshold for the MLS expands the pool of individuals who would face a penalty for not holding a PHI. This policy is designed to push middle income earners to purchase PHI to avoid the surcharge thereby broadening the PHI market base.

### Expected Effect on Market Dynamics

Lowering the income threshold for the 1% Medicare Levy Surcharge will make PHI more appealing for middle-income earners who are earning between \$50,000 and \$93,000 for singles, and \$100,000 and \$186,000 for couples/families and who wish to avoid the surcharge. This increases the demand for PHI among this income bracket causing a rightward shift in the demand curve.

As more middle-income consumers will be purchasing PHI therefore the quantity sold ( $Q^*$ ) would rise. With this increase in demand and the MLS forcing new takers, an increase in price ( $P^*$ ) is very possible at a rate below stabilized below the MLS penalty still making the higher premium price a better option when compared to MLS. The influx of these consumers could spread risk across a broader base, potentially leading to premium stability or even reduction if insurers pass the cost benefits down to policyholders.

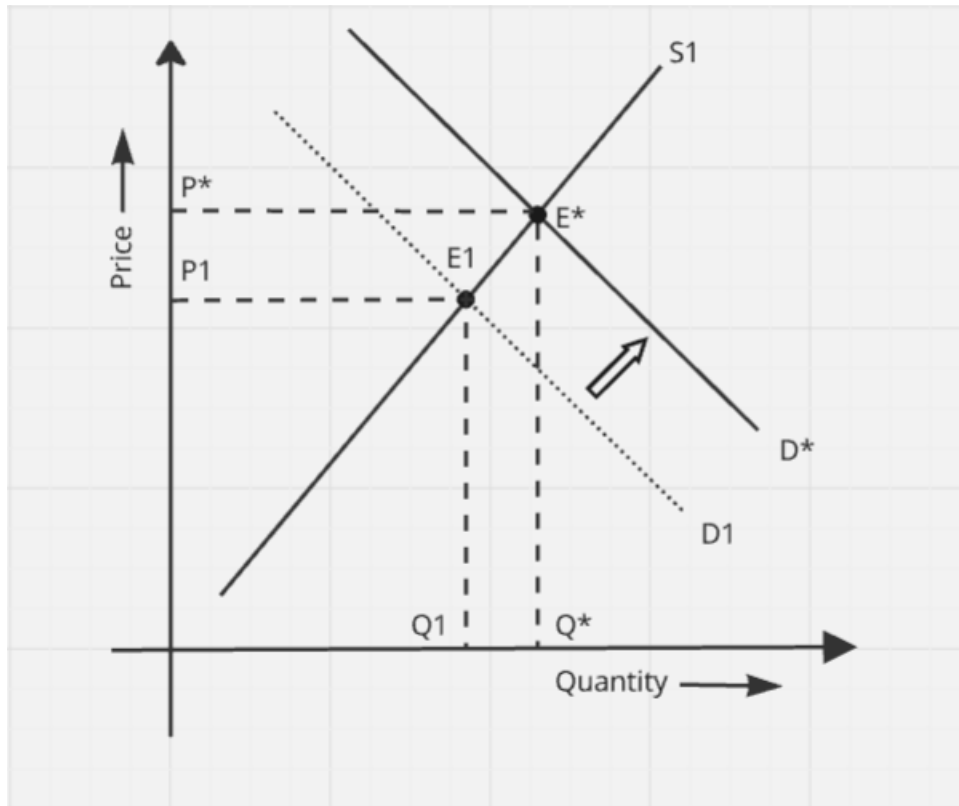


Fig.6: Market Equilibrium change through Demand-Supply curve

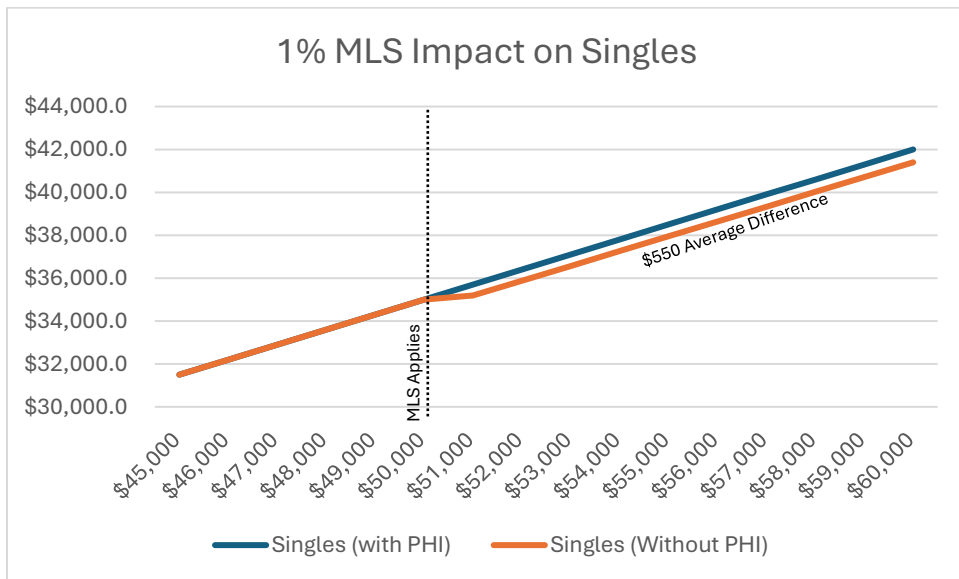


Fig.7: 1% MLS impact on Singles

## **Economic Reasoning**

This policy indirectly incentivizes PHI demand by introducing an economic cost for remaining uninsured. Those above this threshold may view this penalty as an unnecessary expense and hence get private insurance to avoid it.

The MLS was designed to incentivize higher-income earners to reduce public health care reliance. By lowering the threshold, the policy broadens this incentive to middle income earners thereby encouraging a larger segment to take up PHI in order to reduce the Public health care burden.

## **Winners and Losers**

The Public health care system and insurers are the only winners in this situation as burden on public hospitals decreases and a greater number of less risky patients join the pool.

Middle-Income earners just at the threshold might be forced to buy insurance reducing disposable income. Those who continue without the PHI bear the cost of the penalty.

## Policy 3

### Policy Description

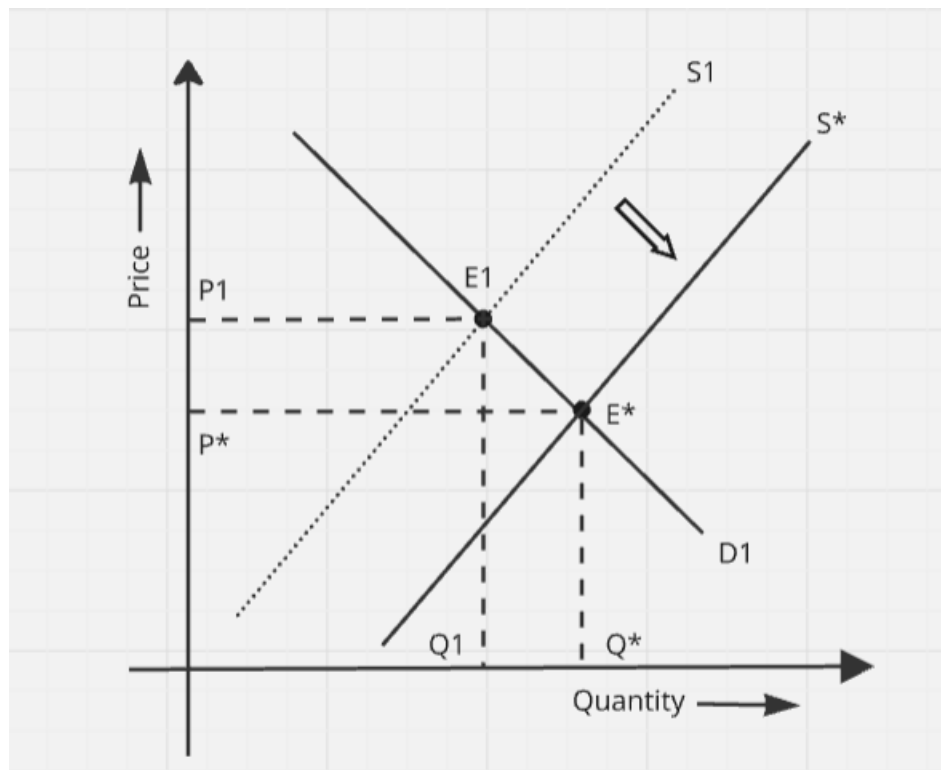
- Implementing regulatory reforms to the production and supply of medical equipment, which are expected to lower the price of surgeries and hospital care.

This policy focuses on reducing the production and supply cost of medical equipment through regulatory reform. Lowering these costs can lead to decreased overall medical care costs which can be passed on to consumers through lower premiums.

### Expected Effect on Market Dynamics

Lowering the cost of medical equipment through regulatory reform lets the insurers reduce expenses associated with surgeries and hospital stays. This could decrease premiums thereby making PHI more affordable. The supply curve shifts rightwards as insurers now supply PHI at a lower cost.

This rightward shift in the supply curve would lead to a decrease in the equilibrium price ( $P^*$ ) for PHI and an increase in the quantity ( $Q^*$ ) sold.



*Fig.8: Market Equilibrium change through Demand-Supply curve*

### **Economic Reasoning**

Reducing medical equipment costs addresses one of the fundamental expense drivers in PHI. By decreasing these operational costs, the insurer can offer more competitive premiums which can potentially attract both younger and older consumers and stabilize the market by curbing premium inflation. Demand for PHI is somewhat elastic meaning that a decrease in premiums could attract a substantial increase in insured individuals, especially those on the margin of affordability. The long-term effects of lower cost create a cycle where PI becomes progressively more affordable, reducing the need for other subsidies or interventions over time.

### **Winner and Losers:**

Consumers across all age groups benefit from lower premiums, Healthcare providers may see an increase in demand in demand as medical treatments become more affordable.

On the other hand, some medical equipment suppliers may face reduced profit margins due to regulatory cost pressures.

## Conclusion

In conclusion, the Australian Private Health Insurance (PHI) market faces significant challenges, particular in retaining young, healthy individuals whose departure could lead to death spiral of rising premium and declining enrollment. Based on the data, it is clear that this decline has already started. The three government policy options analysed in order to solve this decline were an age-based subsidy, lowering the Medicare Levy surcharge threshold and regulatory reforms to reduce medical equipment costs with each offering unique strategies to address these issues.

An age-based subsidy (Policy 1) effectively targets the root cause of the market instability by attracting younger consumers to the insurance pool, helping stabilize premium and prevent adverse selection.

Meanwhile, lowering the Medicare Levy Surcharge Threshold (Policy 2) provides a strong incentive for middle-income earners to purchase PHI thereby alleviating some pressure on public healthcare while expanding PHI demand.

Regulatory reforms to reduce medical equipment costs (Policy 3) offer a more indirect but sustainable approach which can potentially lower premiums across the board by reducing insurer costs and supporting broader market affordability.

Among these options a combination of Policies 1 and 3 is recommended. Policy 1 directly mitigates the risk of a death spiral by securing a balance insurance pool while policy 3 provides a long -term reduction in healthcare costs which would further support market stability. This dual approach aligns with the government's objective of delivering high quality healthcare at the lowest possible cost. Additionally, while policy 2 could effectively increase PHI demand and its coercive nature might place undue financial burden on middle-income individuals without addressing premium affordability leaving them at the mercy of insurer pricing.

Overall, deploying policy 1 and policy 3 would both strengthen the PHI market and ensure a more resilient healthcare system for Australian.

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