

Adverse Selection in ACA Exchange Markets: Evidence from Colorado*

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Abstract

This study tests for adverse selection in the recently established Affordable Care Act (ACA) health insurance exchanges, and quantifies the consequences for consumer welfare and market efficiency. Using a new statewide dataset of medical claims from Colorado, I use plausibly exogenous premium variation generated by geographic discontinuities to test for adverse selection. In this context, a positive relationship between premiums and medical spending of the insured population indicates adverse selection, as the lowest cost individuals are the first to drop out of the market in response to rising premiums. I find evidence of adverse selection in the non-group market, where a 1% increase in premiums leads to a 0.8% increase in the average annual medical expenditures of the insured population. I then estimate insurance demand using the same geographic premium variation. Together, the demand and cost estimates provide a framework for calculating the welfare loss due to selection, as well as an evaluation of policy interventions. My estimates indicate that providing additional premium subsidies would enhance welfare in this market, and moreover, due to heterogeneity across age groups in both demand and costs, I estimate that age-targeted premium subsidies can be a more cost-effective use of public funds to enhance welfare. These results offer the first quasi-experimental evidence of adverse selection directly in the new ACA Exchange markets, and conclusions from the policy evaluations can have implications for effectiveness going forward of this cornerstone of the ACA.

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