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Insurance Purchases of Older Americans

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The great majority of Americans 65 and older receive health care benefits from Medicare, a mostly free, single-payer program that covers most health care services. Traditional Medicare does not cover the complete cost of health services, however, as it imposes deductibles, co-insurance, and co-payments. As a result, there is an active market in "Medigap" insurance, privately provided health insurance designed to cover these "gaps." Due to Medicare's relatively high cost-sharing requirements, most Medicare beneficiaries have Medigap or other coverage that supplements Medicare. Understanding who buys Medigap as well as Medigap's impact on medical spending is important for understanding how individuals manage medical expense and other risks in old age. Furthermore, because Medigap makes health care received almost free, Medigap potentially induces an inefficiently high level of health care consumption. As a result, there have been proposals to limit Medigap either by mandating minimum deductibles or by enacting surcharges on Medigap premiums.

Our data and framework allow us to consider multiple reasons for why individuals do or do not purchase Medigap insurance, in particular: (i) adverse selection (i.e., those who are less healthy and more likely to need health care have an incentive to buy more insurance); (ii) crowd-out by publicly-provided Medicaid insurance or medical debt default (i.e., those who believe they can default on debt or think they may be eligible for Medicaid coverage in the future may see no need for additional insurance); and (iii) behavioral factors such as risk tolerance and cognition (e.g., individuals' attitudes to risk may impact whether they buy insurance).

We combine administrative Medicare and Medicaid records with out-of-pocket spending data found in the HRS and imputations for other payors based on Medical Expenditure Panel Survey (MEPS), resulting in a nationally representative long panel of medical spending by all payors for older individuals, the first of its kind. These data are then linked to the broad set of covariates available in the HRS. This data set allows us to assess whether Medigap enrollees have higher or lower medical expenses than nonenrollees, and whether there are health, behavioral or financial factors that are also correlated with the Medigap purchase decision. Relative to the data sets used in previous analyses of the Medigap purchase decision, these data form a longer panel and cover a broader range of variables.

We find that total medical spending of those who

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purchase Medigap insurance is approximately $2,300 more than those who do not. However, we find no evidence that adverse selection drives higher spending. In fact, we find that those who purchase Medigap are in better health, consistent with the hypothesis of "advantageous selection" in this market. Turning to alternative explanations, we find some modest evidence that crowd out and behavioral factors, such as risk tolerance and cognition, are important for understanding Medigap purchases. However, these factors do not explain the higher medical spending of those purchasing Medigap. Instead, our results are consistent with moral hazard, where those who purchase Medigap pay little out-of-pocket at the margin for additional health care and, therefore, may demand more care than is efficient. ❖

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