

Title: Advantageous Selection in Private Health Insurance: The Case of Australia

Abstract:

A basic prediction of theoretical models of insurance is that if consumers have private information about their risk of suffering a loss there will be a positive correlation between risk and the level of insurance coverage. We test this prediction in the context of the market for private health insurance in Australia. Despite a universal public health insurance system that provides comprehensive coverage for inpatient and outpatient care, roughly half of the adult Australian population also carries private hospital insurance. The main benefit of private insurance is more timely access to elective hospital treatment. Like several recent studies using data on different types of insurance in other countries, we find no support for the positive correlation hypothesis. Indeed, individuals with private health insurance have a lower ex ante risk of hospitalization than those without such coverage. Because strict underwriting regulations create strong information asymmetries, this result suggests the importance of multi-dimensional private information. Several pieces of information suggest that the advantageous selection observed in this market is driven by the effect of income and risk aversion, both of which are positively correlated with insurance coverage and negatively related to the probability of being hospitalized.