ECONOMIC VIEW

Why So Many People Choose the Wrong Health Plans

By Richard H. Thaler

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If you get health insurance from your employer, you have to make decision every year about which coverage to choose.

So here is a warning: If you are simply sticking with an old plan with a low deductible, that may well be a wrong and costly choice.

You might wonder how anyone could say that choosing one plan over another is “wrong.” Surely such a choice depends on personal preferences about doctors, premiums, deductibles and other factors. And that’s all true.

But the mistake I am referring to is different. Because of human quirks, lack of understanding and overly complicated plans, many people are paying more without getting anything extra in return.

Economists have a term for a situation like this, where one option is better than another under any circumstances, dominance. And that is what we see in many workplaces: The cheaper health care plan, at every level of medical spending, often has a higher deductible — a higher spending hurdle that must be reached before reimbursements begin.

Because people tend to keep the older, low-deductible plans they already have — and because they are often frightened by high deductibles — large numbers of workers and their families are spending more than they need to on health care.

In most cases, if employees do not take direct action during the annual open enrollment period, they automatically continue with the previous year’s choice. But even if that was the right choice then, it often is not now.

The 2020 Nobel Prizes

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- See all of the 2020 winners here.
- Drs. Harvey J. Alter, Michael Houghton and Charles M. Rice received the prize for medicine for their discovery of the hepatitis C virus.
- Roger Penrose, Reinhard Genzel and Andrea Ghez received the physics prize for their discoveries that have improved understanding of the universe, including work on black holes.
- Emmanuelle Charpentier and Jennifer A. Doudna were awarded the chemistry prize for their work on genome editing.
- The Nobel Prize in Literature was awarded to Louise Glück, the American poet.
- This year’s Peace Prize was awarded to the U.N.’s World Food Program.

According to the Kaiser Family Foundation, 49 percent of the United States population receives health insurance through an employer-supplied plan. And several studies indicate that a sizable fraction of employees choose needlessly expensive plans with low deductibles when high-deductible versions are available. (High deductibles are still unusual for health maintenance organizations, which limit consumers to a single provider.)

At one firm studied by Benjamin R. Handel, an economist at the University of California, Berkeley, the most-popular option was a health plan with a low, $250 deductible. Professor Handel’s study showed that employees would have saved money and received the same services, whatever their spending on medical expenses, if they had shifted to a plan with a $500 deductible.

But only 11 percent of people in the dominated plan (the plan that is more expensive at every spending level) switched to the less expensive one. The cost of this inaction was enormous: Employees spent $4,500 spent per year on health care annually, on average, and could have saved $2,032 with the cheaper plan.

Simply providing consumers with good options doesn’t ensure that they will choose wisely. Three economists, Saurabh Bhargava and George Loewenstein of Carnegie Mellon University and Justin Sydnor of the University of Wisconsin, examined the problem in a 2017 paper. They studied an anonymous, large company that gave employees many choices.
The company's workers could choose from among 48 different combinations of deductibles, prescription-drug co-payments, co-insurance rates and maximum out-of-pocket costs. (Each version offered the same network of doctors and hospitals.) The results were troubling: A majority of employees selected financially dominated plans — generally, those with low deductibles, which were worse in every spending scenario.

The employees who picked plans with a deductible of $750 rather than $1,000, for example, were essentially paying $528 to reduce their deductible by $250. That is not smart. But the authors showed that people often do not understand the choices they are making when it comes to health insurance.

The research cited so far examined choices with deductibles of $1,000 or less. But in recent years many employers have offered plans with much higher deductibles, sometimes $3,000 or more for a family. These plans are often cheaper for employers, partly because higher deductibles appear to have the effect of decreasing consumer spending. But they are often cheaper for consumers too. Yet there is evidence that most people are not choosing them.

Professor Sydnor and Chenyuan Liu, a University of Wisconsin colleague, studied 331 firms that offered high- and low-deductible plans with an average difference in deductibles of $1,300. Their analysis showed that for as many as half of the companies, the high-deductible option clearly appeared to be the smart choice for nearly everyone. (In the remaining companies, individuals would have needed to assess their expected health spending to know which plan was better for them.)

Counterintuitively, the “no-brainer” high-deductible plans were not only cheaper. They were less risky for consumers because they capped out-of-pocket costs at a lower level.

People make exorbitant health care choices for reasons that include:

- Inertia. It is easier to stay with a plan picked a long time ago.
- Math. It is time-consuming and, in some cases, challenging to do the calculations required to assess these plans.
- Deductible aversion: Many people seem to hate deductibles, whether for home, car or health insurance. They may not be comfortable with the burden of deciding whether a particular expense is worth it. And there is evidence that patients facing cost-sharing sometimes cut back on valuable things like diabetes medicine.

There are, however, many financial incentives for going the high-deductible route. Some are embodied in health savings accounts, of H.S.A.s, which provide tax breaks and are only offered in combination with high-deductible plans.

Naturally, there is a complication here, too.

It is easy to confuse H.S.A.s with the older flexible savings accounts, or F.S.A.s. Both types of account allow people to pay out-of-pocket health costs with pre-tax dollars, but F.S.A.s have a reputation for being annoying on two counts:

- Claims can be rejected for mysterious reasons.
- If you do not spend the money in an F.S.A., you lose it.

In contrast, no approvals are required with an H.S.A. When you incur a cost that insurance does not cover, just swipe a debit card and you are done. Moreover, any money unspent in a given year remains yours. You can use it to pay future medical costs or as an investment for retirement.

There is another compelling advantage: Many companies contribute to these accounts for their employees.

But if employers really want to encourage the use of such plans, they could improve them. An approach that I like is to raise premiums just enough so that the extra money, if put in an H.S.A., would cover all of a deductible (or, even better, an employee's entire maximum out-of-pocket costs). When the high-deductible plan dominates the low-deductible one, this could still save employers money.

Yet it would help employees by creating an environment in which policyholders would effectively not have to worry about deductibles (or other out-of-pocket costs). Rather, any money spent before reaching the deductible could be paid from the H.S.A. account, while subsequent costs would be covered too. Deductible aversion solved. Perhaps patients would also not be tempted to scrimp on needed treatments.

Another snag that needs a workaround: H.S.A.s have traditionally been funded starting on Jan. 1 with a payment from the employer, and then gradually with payroll deductions throughout the year.

This timing can cause problems. It means that a household that runs up a large medical expense sometime in January — one that is larger than the H.S.A. balance at that time — could have a temporary cash crisis. Caring employers could solve this by front-loading money into H.S.A. accounts or by providing low-cost loans to those in need.
I realize this is all complicated. Unfortunately, it is impossible to say which specific plan is best for your family without looking closely at the details, including language regarding "non-preventive drugs," which are covered differently in high-deductible and low-deductible plans.

If you want hints about how to crunch the numbers for yourself, the accompanying article may help you.

It would be better if these choices were simpler and my suggested modifications were adopted. But my main message right now is this: If your employer offers a high-deductible plan paired with a health savings account, choosing it may save you a lot of money and also help you build up retirement savings. This is especially likely if you are young and healthy. If you can handle the possibility of a short-term financial shortfall of a couple thousand dollars for a few months early in the year, it may be your best bet. Otherwise, a high-quality, low-cost health maintenance plan could be a good alternative.

Whatever you do, investigate your options. You may be surprised by what you find.

Richard H. Thaler, a professor of economics at the University of Chicago, has won the 2017 Nobel Memorial Prize in Economic Sciences.

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