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The Federal Employees' Health Benefits Program (FEHBP) – Model or Morass

by Edwin C. Hustead

The FEHBP was established in 1959 as employee health insurance became a standard fringe benefit offered by large employers. In the 1950s, few employers offered health benefits options. However, political compromises resulted in participation in FEHBP by all major segments of the health insurance industry. Today federal employees and annuitants can choose among a wide variety of traditional insured plans and prepaid plans, such as health maintenance organizations (HMOs). Some observers find this odd mixture of options to be a model program, and others find it to be a morass.

There are a large number of plans available, and many enrollees do exercise an educated choice. However, there is clear evidence that enrollees do not always act in their own best interest. Given the shifting cost/benefits ratios (the ratio of employee contributions to expected benefits) among the health plans and the marginal value of some plans, a much larger percentage should change each year if the choice were made on purely economic grounds. However, the over-insurance tendency results in many enrollees staying in the plans with the highest cost/benefits ratios.

The original FEHBP legislation avoided placing the whole program with one sector of the insurance industry by permitting government-wide participation by Blue Cross/Blue Shield (Blues) through a Service Benefit plan and by the insurance industry through an Indemnity Benefit plan with Aetna as the primary insurer. Prepaid insurance organizations were also allowed to participate. Finally, employee organizations (Ee Orgs), which already covered federal employees through beneficial associations were allowed to offer their plans through FEHBP. All these plans are placed into four "categories" by the law. The Blues options and the Aetna options are each a category. The Ee Orgs are a third category, and the final category is the prepaid plans (lumped together as HMOs in the following discussion). The program is run by the U.S. Office of Personnel Management (OPM).

Results of Selection Process

Each year over 4 million federal employees and annuitants have an open season during which they can make or change their election. Actions taken during open seasons in the last decade have significantly changed the proportion in each category of FEHBP plan. In 1978, all employees could join any one of eleven options, and a few could choose from as many as 20 options. In 1988 the choices range from 21 to 35 options. Many employees and annuitants appear to make an educated decision, since the plans with the best cost/benefit ratios gain enrollment and those with the worst ratios lose enrollment. The government-wide plans have experienced steady erosion in membership. Graph 1 compares the enrollment in 1978 and 1987. The two Blues options dropped from 55% to 36% of the total enrollment and the two Aetna options from 14% to 8% of the total. During the same period, the HMOs and other prepaid plans doubled their share, and the Ee Orgs increased from 22% to 38% — collectively higher than the Blues.

Some of the growth in the Ee Org and HMO categories resulted from there being more plans, but most of the growth, especially among the Ee Orgs, has been selection of existing options. The most remarkable growth has been in the Mailhandler's high option, which increased its enrollment from 53,000 to 470,000 members in the last ten years, and the Government Employees' Hospital Association, which increased its enrollment from 67,000 to 317,000. The Blues have managed to keep many of the shoppers in their program by promoting their standard option. The standard option increased its enrollment from 278,000 to 898,000 during the decade, while the high option has declined from 1,578,000 to 493,000 enrollees.

Another significant trend is the percentage of annuitants in each plan. Since the annuitant rolls have been growing and the number of employees has remained almost constant, the entire FEHBP program has seen a growth in the annuitant share of the enrollment from 31% in 1978 to 39% in 1987. However, the share of the growth has been uneven, as shown in Graph 2. The share of annuitants in the Blues options has increased from 33% to 55%, and the share in the Aetna options has increased from 45% to 73%. During the same period, the share of annuitants in the Ee Org plans has increased from 20% to 25%, and the share in the HMOs has seen little change.

From the viewpoint of those who support competition as a way of selecting the most efficient plans, the

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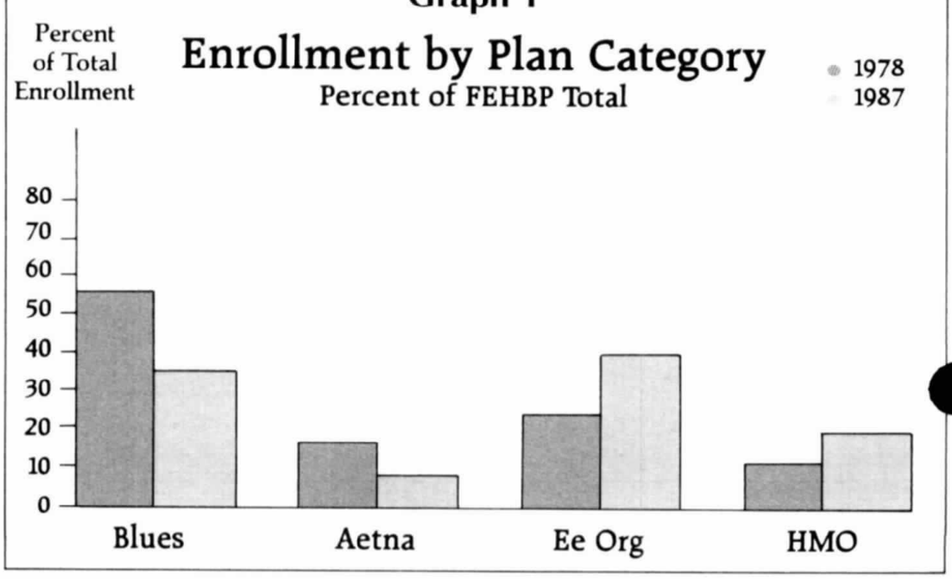
Graph 1



FEHBP cont'd.

program has been a success. From the viewpoint of insurers fearing antiselection, the competition has been a nightmare. Not surprisingly the most outspoken critics of the current system have been Blues officials. Antiselection has worked the expected effect on the Blues and Aetna high options. The better risk enrollees have left these options, and the premiums have been spiraling upward under a classic antiselection curve.

The Blues and Aetna suffer from two problems not encountered by the other FEHBP plans. First, most new employees join one of the government-wide plans because of name recognition. In the succeeding open season the new employees with little or no health costs will move to one of the other options, leaving the Blues and Aetna with the higher-risk enrollees. Second, OPM insists that the Blues and Aetna high options include provisions which attract higher-risk enrollees.

Even though there is an evident educated selection process, a large number of employees and annuitants do not select the most cost-effective plan. For instance, there are still almost 500,000 enrollees in the Blues high option, although the cost/benefits difference for many other options is much better. For instance, most enrollees in the Blues high option would save a significant amount by simply transferring to the low option. Since the high option has a $1,500 out-of-pocket cap and the low option has a $2,500 cap, the maximum benefit difference for most families under Blues high option cannot be more than $1,100 (allowing for differences in deductibles that are outside the cap) and the typical benefit difference is around $100. Yet 215,000 families paid $1,424 more to be in the high option last year, and 278,000 individuals paid $662 more to be in the high option. The Blues high option can pay out more than the premium difference for a family with high mental and nervous costs, but less than 20% of the families have a member who would be expected to need mental and nervous treatment in the succeeding year.

Political Environment of FEHBP

The FEHBP rate and benefit structures are greatly influenced by the fact that the program is mandated by a national law and administered by an organization headed by a political appointee. Since the law specifies the general rules for the program, OPM is limited in its ability to select the best structure and must accept all insurers who satisfy specific legal requirements. The fact that OPM is headed by a political appointee means that decisions are often driven by political and national budget concerns rather than the best interests of the enrollees. For instance, the policy on the level of mental and nervous and abortion benefits has changed with each new Administration.

A more serious political influence comes from the fact that transactions involving the plan funds affect the national deficit. The designers of the original law set up a complex set of funds held in reserve to be used to moderate rate increases or to fund benefit improvements, but frequent rule changes by OPM appear to be driven by the need to meet national budget restrictions. Some of the funds held in reserve are on the books of the government, and any reduction in these funds would add to the deficit. Other funds are held by the insurers, and any reduction in these funds would reduce the deficit. In 1988, for instance, the average increase in premium will be 31%. The increase would have been substantially less if OPM had permitted, or even required, a buildup in funds held in reserve to moderate the current increase. Favorable experience in 1984 and 1985 had resulted in funds that were in excess of OPM reserve guidelines. Prudent use of the funds would have permitted at least some of them to be held against future increases. However, budget goals were best served by keeping the insurer funds to a minimum. Therefore, OPM insisted that the unexpected funds be used either to reduce premiums or to make refunds to participants and the government.

Conclusion

As a political creation which responds to diverse interests, FEHBP cannot be expected to be a model program. Nevertheless it does illustrate what can happen when the enrollee has a wide choice of options. Many enrollees choose the more cost-effective plans, but others make the wrong choice.

OPM is reviewing FEHBP to determine the changes needed to provide the best health coverage for the 1990s. One result will probably be that the FEHBP will add one or more options designed specifically for annuitants who have Medicare coverage. The number of plans added in the future may be limited, and some of the least popular plans may be removed from the program. However, most of the current insurers will remain in the program. Enrollees will continue to have a wide range of choice. Many will exercise an economically sound decision, but unfortunately, many will not. It is unlikely that OPM will suggest that FEHBP be placed with an independent agency; hence, politics and budget concerns will continue to impact on the benefit and rate decisions.

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