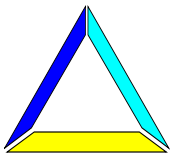
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# Promoting private health insurance in Ukraine

## Executive Summary

Ukraine lacks an efficient health care sector and developed voluntary private health insurance. Much of the reform debate is dedicated to introduce a compulsory state medical insurance. Instead health care reforms should be aimed at increasing the efficiency of health care provision, while the promotion of a market for voluntary private medical insurance could accompany the reforms. Private health insurance should be promoted among the wealthier layers of Ukraine's society, as in case of a successful development it will trickle down into the middle class and lower income strata. The success of private health insurance in Ukraine will depend on sound regulation, transparency, and incentives.

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# 1 Introduction

Ukraine lacks an efficient health care sector and voluntary (further on: private) health insurance remains underdeveloped. For many years a debate is ongoing about the introduction of a compulsory medical insurance as part of the social tax/payroll tax. The step finds support at the Ministry of Health as well as at the League of Insurance Organizations. Even though their concepts differ, both institutions support the attempt to introduce a compulsory medical insurance over the next two years.

However, introducing a compulsory medical insurance would increase even further the already too high payroll tax in Ukraine, pushing wages further into the shadow economy. A compulsory health insurance attached to wages does not take into account the ageing Ukrainian society and the narrowing contribution base of wage related contributions. Instead we suggest to promote the development of a market of voluntary private health insurances.

An ideal and efficient health care sector would be characterized by competition among health care providers as well as by competition among health insurance companies[1]. At the same time, the government should ensure that all individuals receive a defined set of health care services.

We recommend several steps of the health care reform. First, the responsibilities of health care policy, regulation, budget execution and health care management should be separated. The Public medical fund should be created and be responsible for allocation of budget funds to health care, compensation to health care providers for their services, control over delivered treatments. The compensation payments should be allocated for actual treatments and services delivered. Besides, management of health care providers should be commercialized.

Here we argue that Ukraine should additionally promote private health insurance as complementary element within the existing tax financed health care system. Such a complementary private insurance could play a significant part in the multi-channel financing of health care comprised of general taxation and private health insurance[2].

However, without sound regulation the PHI market will be hampered in its development and efficiency. In addition the government should implement policies directed towards active promotion of private health insurance (PHI) in Ukraine. For the success of private health insurance the government needs to improve trust into long-term stability of insurance companies, introduce measures for better consumer protection, foster competition among health care providers and insurers and promote transparency in health care.

The implementation of such measures is a necessary precondition to ensure a sustainable and efficient market for PHI and to open it to the broader Ukrainian audience.

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[1] In order to increase efficiency and improve performance, the government should introduce such measures as fee-for-service payment system, case-mix funding. Moreover, the management of health care providers shall be granted independence and be given commercial incentives. Barriers to competition between private and public suppliers of health care should be removed. For details see policy paper U8 (http://www.ier.kiev.ua/English/papers/u8_en.pdf)

[2] After significant lowering of social taxes to 25-30% the introduction of a flat rate health care payments will be additional source of financing.

## 2 Private health insurance in international comparison

Private health insurance (PHI) provides either parallel, complementary or supplementary coverage in combination with the statutory public health care sector. In all developed countries PHI plays a significant role across all different types of health care systems.

Table 1 indicates, that while in many countries the PHI covers large shares of the population, in all countries it provides only additional financing in comparison to other sources of funding, reaching in the USA 35% of total health care expenditures. In other OECD countries PHI it rarely exceeds the level of 12% of total health care expenditures. The figures reflect the mostly complementary nature of PHI as one additional element to the public health care system.

**Table 1**
Comparison of figures for PHI in OECD and Ukraine

| | Predominant type of Health care system | Share of population covered by PHI (%) | Share of PHI in total health expenditures (%) | PHI in % GDP |
|---|---|---|---|---|
| France | Bismarck | 86 | 12.8 | 1.20 |
| USA | Private insurance | 70.3 | 34.8 | 4.59 |
| Canada | Beveridge | 70 | 11.2 | 1.03 |
| Australia | Beveridge | 44 | 7.1 | 0.65 |
| Germany | Bismarck | 10 | 12.5 | 1.34 |
| Ukraine | Semashko | 1 | 0.25 | 0.01 |

Source: Docteur E., Oxley H., Health-care Systems: Lessons from the Reform Experience, OECD Health Working Papers, No.9, 2003; Colombo F, Tapay N. Private Health Insurance in Australia: a Case Study. OECD Health Working papers No.8, 2003; the Ministry of Health Care of Ukraine.

The varying levels of coverage and popularity of the PHI in developed countries are mostly explained by differences in government regulation and selective incentives. The latter one needs to fit with the individual income situation in order to be effective. Disposable household income is among the most important factors for individual demand for private health insurance.

## 3 Private health insurance in Ukraine

The share of the PHI in the structure of Ukrainian health care expenditures remains very low. According to official data from the Ukrainian Ministry of Health Care (MOH) the PHI accounted in 2003 for only 0.25% of funds received by health care providers from the consolidated budget.[3]

According to estimates of the League of Insurance Organizations of Ukraine, in 2003 the PHI payments reached about 1.2% of total health care spending in Ukraine.[4] The difference in data is explained by the fact that the MoH monitors only state health care providers, which play only a marginal role in the privately insured health care provision in Ukraine.

Private health insurance companies develop individual coverage programs with different volumes of health care services covered and with different conditions for health care

[3] The MoH does not request and receive all information from PHI in Ukraine.

[4] According to the MoH in 2003 the PHI contributed to the system payments amounting to UAH 16.6 m. The League estimated PHI contributions at UAH 163 m, while premiums of UAH 242.8 m were collected.

provision. The most popular insurance products on the market include direct payments to health care providers for services performed, while the insured individual chooses from a list of different health care providers. However, only very few health care providers participate in PHI schemes.

More than 60 insurance companies offer PHI and cover nearly 1% of the Ukrainian population.

Most PHI products are purchased by corporative clients for their employees. As for 2004, the volumes of premiums paid by individuals for the PHI policies accounted only for 30% of total PHI premiums.

On average, the PHI payments to health care providers reaches 60% of collected PHI premiums. This is a rather high share in comparison to other types of private insurance, where such ratio reaches only about 25%.

The insurance premium rates vary from USD 80 and USD 800 per year depending on the volume of health care services covered and the list of health care providers included, etc.

In 2004 the insurance premiums increased by 10-15% due to rising prices for drugs, medical services, etc. At the same time, the number of insured people increased as well. This increased demand for PHI reflects the strong performance of Ukraine's economy and increasing incomes.

Still, household incomes in Ukraine remain rather low, with around 30% of all households receiving incomes below the official poverty threshold in 2003. While most households spending was directed towards the most basic necessities of human existence, i.e. food, utilities and clothing, only 2.8 percent were spent for health care (see Table 2).

**Table 2**
Ukraine: Average household[5] spending per month (2003)

| | **Share of total household expenditures (%)** | **Household spending (UAH)** |
|---|---|---|
| Food products | 58.6 | 431.27 |
| Utility services, housing, electricity | 10.4 | 76.40 |
| Clothing and footwear | 5.3 | 39.24 |
| Transportation | 3.3 | 24.16 |
| **Health care**[6] | **2.8** | **20.83** |
| - goods | 1.5 | 11.11 |
| - services | 1.3 | 9.72 |
| Entertainment, culture | 2.3 | 16.71 |
| Furniture, furnishing, home appliances, etc. | 2.0 | 14.91 |
| Education | 1.1 | 8.18 |
| Other | 15 | 110.39 |

Source: Household Budget Survey, Derzhkomstat

[5] Average size of household was equal to 2.62 persons in 2003.

[6] According to the data of Derzhkomstat on structure of final household expenditures, the share of health care is approximately 4% of final household consumption. The difference may be due to selection bias in the Household Budget Survey.

The amount spent on healthcare translates into UAH 250 per household or UAH 95 per capita (USD 18) for the whole year 2003. The cheapest per capita PHI premium rate on the market was near UAH 400 (USD 80) per year. That indicates that private health insurance is not within the reach of average Ukrainian households. Consequently the strategy of developing the PHI market in Ukraine should be targeted towards households with substantially above average incomes.

The government should promote the development of a parallel private insurance based private health care system for the wealthier parts of the population, because a successful PHI market with sound regulation, transparency and competition among insurers and efficient service provision will certainly later on trickle down into middle class and lower income strata.

While the individual income situation largely determines individual demand for PHI, trust into the companies offering PHI is the most important precondition for any successful development of the market. In market economies trust by consumers into insurance companies develops through quality products and long-term market presence, but also through efficient regulation and transparency of the market.

## 4 Regulation of Private Health Insurance

The provision of private health insurance in Ukraine is regulated by the Law 'On Insurance' (approved in 1996). The law stipulates only general conditions for insurances, such as insurance risks, exceptions from insurance cases, restrictions of insurance, etc. The concrete insurance conditions, in particular insurance premiums, terms and conditions of insurance payments, are to be defined in the insurance contract. There is no specific regulation of private health insurance.

PHI needs to be regulated in its interaction with the public coverage system to ensure a sustainable and fair public health system. Such regulation will define the coverage of services allowed to PHI and the coverage of health care providers. However, due to the specifics of PHI and potential spill over effects a more strict regulation should be in place. Consequently, Ukraine should introduce a regulation requiring a separation of health insurance into specialist undertakings independently of other classes of insurance.

Second, the financial regulation of PHI companies needs to promote the financial stability through solvency and capital adequacy regulations. Ukrainian legislation currently regulates PHI like any other risk insurance.

Premiums for PHI should be subject to approval, as well as new products or changes of existing products, as consumers will rarely be able to comprehend the various covered medical treatments and their effectiveness. Such practice does not exist in Ukraine.

The offerings and activities of PHI companies need to be regulated to ensure equity in coverage, i.e. insurers have to accept all applicants within certain membership categories without regard of gender, age, health status etc[7]. Besides, the insurance should also cover treatment of chronic illnesses. In Ukraine such regulation is not applied.

Since information on the individual health status is asymmetrically distributed between the applicant and the insurer, the applicant has incentives not to disclose the true health record. On the other hand, PHI companies have incentives to turn down applications of individuals in poor health condition. Hence regulation to overcome adverse selection and moral hazard

[7] See Australian experience on this issue: Colombo F, Tapay N. Private Health Insurance in Australia: a Case Study. OECD Health Working papers No.8, 2003.

problems are needed[8]. For example, PHI companies should be allowed to impose waiting periods for certain treatments where pre-existing ailments are apparent and which were not disclosed by the insured. Furthermore, policies should specify front-deductibles to be paid by the individual before the PHI steps in, in order to reduce moral hazard related risks and curb demand for health services. In Ukraine such measures need to be defined.

Consumer protecting regulations need to include such measures as information disclosure requirements and the insurance Ombudsman[9]. The portability of cover of individuals transferring between PHI companies should be regulated to shorten waiting periods and be taken into account for the calculation of benefits and premiums. Ukraine has not yet introduced such rules.

This not inclusive list demonstrates that different institutions need to be involved in the regulation of the PHI.

## 5 Incentives to purchase private health insurance

With proper regulation in place, the government could stimulate the development of the PHI market through selective incentives. In most developed countries certain tax incentives are stimulating demand for PHI, such as:

- Tax incentives at company level, i.e. allowing employers to deduct the premiums paid for PHI of employees from the taxable income, include payments into costs, etc.
- Tax incentives at individual income level (individuals are allowed for tax deduction or a rebate of PHI premiums).[10]
- Tax penalties at the individual income level. For instance, Australia introduced a tax penalty of an additional 1% income tax for individuals with incomes above a certain threshold but without a private health insurance.

However it should be noted here that the latter two measures might be difficult to incorporate with the current 13% flat personal income tax.

Another incentive used is the so-called “Lifetime health cover” in fully funded PHI. For example in Australia and Germany individuals have an incentive to purchase PHI at younger ages in order to enjoy low and stable premiums over their whole lifetime. In other words, who joins earlier in his life enjoys lower premiums.

In Ukraine most incentives to purchase a PHI are attributable to the failure of the public health care system, like the individual desire to overcome the restrictions of the ‘catch-up’ principles or the jumping of long waiting lines in public hospitals and poor health care provision. Corporate purchases of PHI for employees are stifled somewhat, as insurance premiums have to be paid from after tax profits and cannot be deducted from taxable income.

## 6 Policy recommendations

The development of PHI should be supported by the following measures:

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[8] Moral hazard problem is explained by the fact that people with poor health are more likely to purchase the PHI policies, what creates risks for insurance companies. At the same time, the insurance market also faces the risk of adverse selection, when insurance companies will permit only to healthy people to insure their health, while people with poor health will be excluded from the PHI via very high insurance premiums or special rules of insurance companies.

[9] For details see policy paper T31, Improving Dispute Resolution in Ukraine’s Insurance Sector: Proposal for an Insurance Ombudsman (http://www.ier.kiev.ua/English/papers/t31_en.pdf).

[10] For example, in Australia individuals are allowed for 30% rebate on PHI premiums.

- The MOH should define a basic catalogue of medical treatments and services that should be guaranteed by state for every individual.
- The Verkhovna Rada should pass a law defining private health insurance in Ukraine. PHI should allow for complementary health care, reimbursing patients for costs for services and medical goods that are not publicly financed.
- The Ministry of Health Care should define PHI in its health care interaction with public coverage system according to the basic medical catalogue.
- The MoH and the Verkhovna Rada Health Committee should together develop proper regulation ensuring equity.
- The management of health care providers should be commercialized.
- The State Commission of the Financial Markets Regulation (State Commission) should continue playing a role of financial regulator. Health insurance companies should be separated from other companies, since health insurance differs from subjects of other risk insurance.
- The State Commission should stimulate the creation of a reinsurance pool, equalizing the costs of elderly and chronically ill or permanently hospitalized. This pools the most risky groups of individuals across companies with different risk structures. Such policy also ensures equity and fair competition across insurers with different risk structures.
- For protecting consumers and building confidence the League of Insurers should set up an Insurance Ombudsman. It should resolve consumer complaints relating to the PHI and act as a judge in dispute resolution.
- The government should allow the development of a parallel private health care system for the wealthier tiers of population, as later on the PHI will trickle down towards broader groups.

Only when proper regulation is in place the government should promotion of PHI via incentives. The present regulation that corporate PHI should be paid from enterprise profits should be abolished. Instead, the companies should be allowed to include reasonable PHI costs into the balance sheet.

Kyiv/Berlin, October 2005, Lars Handrich and Oleksandra Betliy

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