Market Power and Insurance Coverage

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Abstract:
This paper studies how market power affects allocations in markets with adverse selection, such as insurance markets. We show that market power reduces coverage for individuals with lower willingness to pay for insurance while increasing it for those with higher willingness to pay. Under weak conditions, a monopolist always excludes a positive share of customers, whereas competitive firms provide coverage bounded away from zero to all customers. However, to avoid cream skimming, competitive firms offer less coverage to high-willingness-to-pay consumers than a monopolist. The welfare comparison depends on whether the distortion at the bottom (higher under monopoly) exceeds the distortion at the top (higher under competition). Using simulations based on an empirical model of preferences and costs, we find that both effects are quantitatively significant, with the distortion at the lower end dominating. More generally, we provide tools to study competitive equilibrium in a wide class of multidimensional models.