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Mark Pauly on the Individual Mandate

Knowledge@Wharton: Thanks so much for being with us today. As we all know, the U.S. Supreme Court has recently heard arguments both for and against President Obama's health care reform initiative known as the Affordable Care Act. One of the provisions of the law that has gotten a lot of the attention, particularly in the court case, is the individual mandate, which requires all adults to buy health insurance either through their employers or by buying it themselves. What are your feelings about the provision as it stands in this act and are you in favor of it, and why or why not?

Mark Pauly: First of all in the spirit of division of labor, I need to say that the primary arguments for and against the individual mandate are lawyer arguments, not economist arguments. So I'm going to speak about it as an economist. But the key issues that were debated before the Supreme Court -- like, is it Constitutional to affirmatively make a person buy something or how far does the interstate commerce clause extend? -- I'm not an expert on. There are, however, two good reasons to have the individual mandate in any kind of health reform legislation.

The one, which has gotten the most discussion recently, is -- and whether it's necessary or not we could debate -- an important adjunct of a provision of the legislation which essentially says insurers have to charge everybody the same premium no matter what the risk level. The problem with that, of course, is that if you're an average person -- and this is not some kind of reverse Lake Woebegone, where we're all sicker than average -- the average person is reasonably healthy. If the premium is high enough to cover the cost of people with chronic conditions, it will look like a bad deal to a lot of those people. So you need, in a way, some muscle to tell them, "You have to buy the insurance anyway, even though it doesn't sound like such a good deal to you." So that's one reason.

The other reason, which was actually more important when we first considered this 20 years ago, arises because even if you were an average risk person and the premiums were tailored to your risk, we know that somewhere between three and four percent of people just don't get the idea that they ought to have insurance. We know that when they're offered a really good deal as part of their job, they only have to pay a few hundred dollars a month, there still will be three or four percent of workers who will turn it down and not get insurance anywhere. Why are they doing that? Well, one reason probably is, unlike me, they don't get up every morning and think about health insurance. They think they're healthy, and why buy insurance if you're healthy? There's also the view that, well, if I get really sick, no one's going to leave me bleeding in the street. In fact federal law requires you to be treated at an emergency room and stabilized, regardless of your ability to pay. So in a way, people will rely on the charity of others to compensate for the fact that they don't have insurance.

I tell people, it's still a terribly bad idea to run around without health insurance no matter what you are and no matter how much you count on charity. But the one good feature of charity is at least it's cheap if you're the object of charity. We actually originally called our proposal the Proposal For Responsible National Health Insurance because we thought it was important to have a mandate to deal with irresponsible behavior on the part of a small minority of the population, surprisingly not necessarily the poorest people, just the people who don't have the idea that they need insurance. The non-poor uninsured tend to be people who don't buy other kinds of insurance. They don't have life insurance, insurance on their cars. They live from paycheck to paycheck. They're maxed out on their credit cards even if they have a pretty decent income.

So since the challenge at that time was to come up with a plan to get universal health insurance coverage, we thought that it was important to have a mandate to kind of round up the stragglers.

Knowledge@Wharton: There so many other provisions to this law besides the individual mandate. Could you tell me what your opinion of this act is overall? And what do you think the impact would be if the Supreme Court strikes down the individual mandate, or if it strikes down the whole law? What is the impact on health care?

Pauly: Yes, so I'm really worried that. There are some really good parts to the law. And in some ways the features that are around the individual mandate, because they were put in there, run the risk of bringing down the whole edifice. The part that in my opinion is very desirable is a part that's actually not been very much discussed. The law is going to provide hundreds of billions of dollars worth of subsidies, not just to poor people, but to lower middle income people to help them afford health insurance. My view is, as a human being and as a moral person, is that it is socially undesirable and morally undesirable for people to go without highly beneficial care when it exists.

Most of the heavy lifting in the law to get people insured comes not from the individual mandate, but from the fact that if you can't afford insurance, the government's going to step in and really give you major help to afford it. As I said, the mandate mostly just kind of rounds up the people who aren't persuaded enough by an enormous subsidy that they ought to go ahead and get insurance.

That part, in a way what I call paying higher taxes in order to have a clean conscience is, in my view, the most important part of the legislation. It would be a real tragedy if all the other things that were added onto it for various reasons brought down the main objective.

Knowledge@Wharton: If the court strikes down part of the law or all of the law, what is the impact on businesses? What is the impact on consumers? And is there a

way that Congress and the administration can come together and find something that might be able to stick and that everybody could agree on?

Pauly: My view is … if we could just fix some things, we could have something that would make sense. There's of course a political choice of whether you think the best way to fix it is to throw the whole thing out and start over -- I hope still retaining generous subsidies to the people who need help to buy health insurance. Or whether you think you could somehow adjust a bunch of the other provisions of the law in order to make it possible to do that. That is kind of a political choice.

I think if the centerpiece of the law is the subsidies, it's certainly possible to design the other parts of it to do two things. One is, just be much simpler. The problem was, as you can imagine, our elected representatives in Congress who hung all sorts of things on the legislation that have little to do with the uninsured and a lot to do with various crusades that they might be engaging in. That complication has been very harmful to generating support for the law. It's just gotten so complicated.

There is one thing in the law that's related to the mandate that I think could have been done a lot better, and that gets back to the point I was making a few minutes ago. The purpose of the mandate is to force people who are relatively low risk to pay more for their insurance. Well, why do we want to do that? There is a good social reason to do it for people who are unusually high risk, especially if they're not very well off and can't afford to pay an insurance premium that would reflect their risk. So we want to cross subsidize them. The problem I think with the way it's in the legislation is that it's what I call the dumbest possible way to do a good thing.

We're trying to make a transfer to people who need some help to buy insurance because they're high risk. The way the legislation does it is, in effect, by taxing people who are low risk. Then the people who are low risk don't want to pay the tax. The alternative, which actually exists in the legislation, is to create a pool for high risks where if you are a high risk person who has diabetes, say, or some serious chronic condition, you can go there and buy insurance at reasonable premiums. The subsidy comes, not from making insurance expensive to low risks, it comes from raising taxes the way we usually raise taxes on people based on their ability to pay or at least based on their willingness to pay to help out others. So the main part that has been harmful is that the lawyers who drafted the legislation thought they would help out high risks by punishing low risks. I think that was unnecessary.

Knowledge@Wharton: There has been a lot of talk about who the main culprits are with respect to the problems facing the health care system, whether it's the insurance companies, the hospitals, the doctors, the government, the consumers. What do you are the roots of the problems?

Pauly: Insurance companies certainly were the designated enemies. [Regarding] the requirement that insurers cover high risks at the same premiums … well, how will insurers do that? [Some people said] they will do that just by taking the money out of their profits, and we will just make them do it. But of course you can't make insurers do anything. They'll turn around and charge the rest of us more, which is what probably will happen if and when community rating and whether or not it has the individual mandate come into play.

So it's really hard to stick it to insurers as long as they have the ability to vary the premiums they charge. The law is not going to take that away, although it does have some provisions that they can't charge unreasonable premiums. But essentially the reason they charge a lot is when they have to pay out a lot. Most of the money that goes to insurers comes back to us in the form of health care claims.

It's certainly commonplace to quote the horrible figures on the rate of growth in insurance premiums outrunning every other economic aggregate, although lately they have been slowing down a lot…. But the reason why insurance premiums rise rapidly for the most part is not because they're pocketing a lot more money than they used to; it's because they're paying out a lot more in claims.

Why are they paying out a lot more in claims? It's because you and I are going to the doctor, not so much more, but to get more done at a higher price sometimes. So the main culprit for high health care cost in the U.S.? It's easy to find that person. Look in the mirror. That's one of the reasons why health care costs are high.

Knowledge@Wharton: What would you say is the one thing that we should do to tackle rising health care costs?

Pauly: The economist's party line here is to say that the most serious impediment to an economically efficient health care system is connected to health insurance. And the most serious impediment there is a substantial tax break that's generated if you get your insurance through your job, like all of us do or almost all of us do -- all but about six percent of the privately insured get insurance through their job. The beauty part of it, from the point of view of an individual, is that Penn [for example] pays or is able to make payments toward my health insurance in such a way that I figure to shield about $18,000 worth of income from my taxes. My wife says we should send a Christmas card to the Treasury thanking them for that tax break. But the consequence of it is, in part, that I'm less parsimonious than I might otherwise be in choosing insurance and in choosing health care, because, in effect, the Treasury is sharing the cost. This tax break, of course, is a middle class tax break so people who are mostly middle class don't see what's wrong with it. But it has the consequence of providing a pretty strong incentive for ordinary Americans not to be as careful about health care costs as they should be.

Knowledge@Wharton: Are there any initiatives going on anywhere, or that are in progress, that would work well?

Pauly: It actually surprised me and pleased me that there is in the legislation a provision -- not to take effect until 2018 -- to try to take away the subsidy to employment-based health insurance for very high cost employment-based health insurance, a so-called Cadillac tax. However, they didn't do it the right way. What they should have done was said, "If you have a health plan that's costing more than $22,000 a year, at least some part of that ought to be treated as part of your taxable income. And that will make you want to be more careful."

Instead, partly for appearances sake, they imposed a tax on insurance companies. But of course the insurance companies won't pay that tax; they will shift it back to the employers and the employer will probably shift it back to us in the form of lower raises than we would otherwise get. So that was a good thing, although it's pretty small and pretty long delayed. If I were to rewrite things, I would say give that a lot more muscle, make it a lot more rational and move it up in time. That's essentially what the two deficit reduction committees proposed to the Congress and to the President as well, to change the tax treatment of employment-based health insurance. That would be my main thing.

This is a necessary condition for people to really care about the cost of health care personally, as opposed to being outraged about it generally. But if people did care more about their own personal cost of health care, then I think other things -- like better information about where I can get a reasonably good deal on health care -- would be something people would pay a lot more attention to than they do now.