Mandates

PH 126: Introduction to Health Economics and Policy
UC Berkeley

March 6, 2008

Candidate videos

- Ohio Democratic Debate, February 26, 2008: Part 1 (from 3:25)
- Ohio Democratic Debate, February 26, 2008: Part 2
- John McCain with the Kaiser Family Foundation (to 3:55)

The logic of mandates

Why should health care be mandatory?

- Adverse selection
- Free-rider problem

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Four assumptions are needed to generate adverse selection.

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- Risks vary across the population
- Risks are pooled and patients are charged an average price
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Idea:

> *[M]ost insurance prices are based upon an average rate for an entire class or group. Some insureds within each class will be [healthier] than average and some [sicker] than average . . . [T]hose persons who know they are [sicker] than average will be most likely to desire the insurance contract.*

Adverse selection: An example

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Imagine a world with four types of people; one type has no medical costs, another has \$4 in costs, the third has \$8, and the last group has \$12. The groups are equally-sized, each containing 10 people.

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So, patients with the highest health care costs could buy insurance, *if the price was actuarially fair*.

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Since we expect insurance to be sold for prices above the actuarially fair rate, **no one buys health insurance**.

Adverse selection: An example

If health insurance was mandatory, the actuarially fair price would be \$6. The two “healthy” groups would be forced to buy health insurance against their will. This allows the health insurance market to form, as the healthy people subsidize the “sick” people.

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Is this good?

- What if the sick people are mostly poor and the healthy mostly rich?
- What if people can control their health?

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An alternative formulation

Do we believe this result?

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It can't be entirely true—insurance markets exist.

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- Patients have different tastes for risk

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Moral hazard: Patients buy insurance, but, because they avoid risk via the coverage, they do not take actions to reduce risk.

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Hence, people who buy insurance are more likely to be *low risk* individuals. This is called *propitious selection*.

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More on propitious selection:
Hemenway, David. 1990. "Propitious Selection." *Quarterly Journal of Economics*. 104(4): 1063–1069.

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If these patients are covered, then these health care costs won't be passed on to everyone else.

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