CBO MEMORANDUM

THE BUDGETARY TREATMENT OF AN INDIVIDUAL MANDATE TO BUY HEALTH INSURANCE

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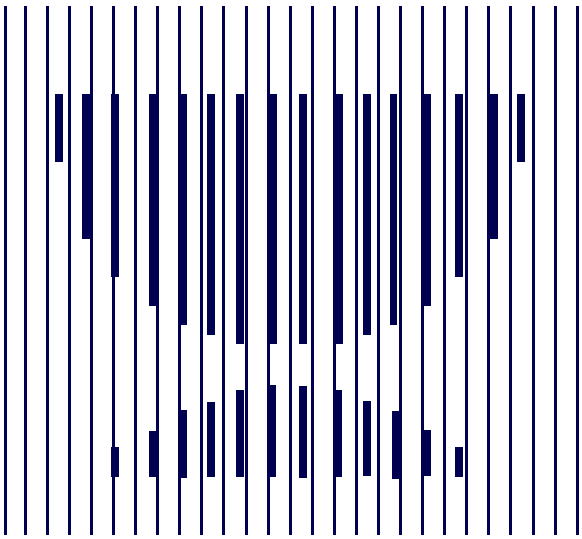

CONGRESSIONAL BUDGET OFFICE

THE BUDGETARY TREATMENT OF AN INDIVIDUAL MANDATE TO BUY HEALTH INSURANCE

August 1994

This Congressional Budget Office (CBO) memorandum was prepared as part of CBO's continuing analyses of budget concepts and health care reform proposals. It discusses the pros and cons of including in the federal budget governmentally mandated payments by individuals for the purchase of health insurance. Robin Seiler of CBO's Special Studies Division prepared the report under the direction of Robert Hartman and Paul Van de Water. The author thanks Gail del Balzo, Thomas J. Cuny, Douglas Hamilton, and Pearl Richardson for helpful comments. Matthew Eyles prepared the memorandum for publication. Questions about the analysis should be directed to the Special Studies Division at (202) 226-2616.

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SUMMARY

Several of the health care reform bills being considered by the 103rd Congress contain mandates by the federal government that would require individuals, employers, or a combination of both to purchase health insurance. The imposition of an individual mandate, or a combination of an individual and an employer mandate, would be an unprecedented form of federal action. The appropriate budgetary treatment of such a policy, therefore, has not been addressed.

The traditional sources of guidance on such matters do not resolve the issue of whether the costs of complying with an individual mandate should be included in federal budget totals. There are good arguments both for and against inclusion of these costs in the budget. It is therefore not only appropriate but necessary that the Congress and the President explicitly decide the proper budgetary treatment of an individual mandate if one is to be part of any health care reform legislation.

INTRODUCTION

Several of the health care reform bills introduced in the 103rd Congress contain "mandates" that would compel individuals or employers to purchase health insurance. Proposals that contain an individual mandate include Senator Mitchell's proposal (amendment 2650 to S. 2351) and the bill reported by the House Committee on Ways and Means. Senator Chafee's bill, S. 1770, would only impose an individual mandate. In general, the requirement would apply to all U.S. citizens and legal permanent residents except those opposed to health plan coverage for religious reasons. Individuals and families could satisfy the mandate by purchasing coverage from a qualified private health plan or by participating in a public program such as Medicare or Medicaid. Those who failed to comply with the mandate would be subject to a tax or other penalty.

AN INDIVIDUAL MANDATE WOULD BE UNPRECEDENTED

A mandate requiring all individuals to purchase health insurance would be an unprecedented form of federal action. The government has never required people to buy any good or service as a condition of lawful residence in the United States. An individual mandate would have two features that, in combination, would make it unique. First, it would impose a duty on individuals as members of society. Second, it would require people to purchase a specific service that would be heavily regulated by the federal government.

Federal mandates typically apply to people as parties to economic transactions, rather than as members of society. For example, the section of the Americans with Disabilities Act that requires restaurants to make their facilities accessible to persons with disabilities applies to people who own restaurants. The Federal Labor Standards Act prohibits employers from paying less than the federal minimum wage. This prohibition pertains to individuals who employ others. Federal environmental statutes and regulations that require firms to meet pollution control standards and use specific technologies apply to companies that engage in specific lines of business or use particular production processes. Federal mandates that apply to individuals as members of society are extremely rare. One example is the requirement that draft-age men register with the Selective Service System. The Congressional Budget Office (CBO) is not aware of any others imposed by current federal law.

An individual mandate would differ from the requirement in the Administration's Health Security Act that employees, self-employed individuals, and those not connected to the labor force make payments to health alliances. The Administration's bill would establish a new federal entitlement to health insurance. Health alliances would function as agents of the government in administering the provision and financing of the entitlement. Therefore, in CBO's view, the mandatory payments that employers and individuals would

make to the alliances would represent federal receipts.[1] By contrast, other proposals that would impose an individual mandate would require individuals and families to make payments to qualified health plans, which would be unaffiliated with the federal government, rather than to alliances or their equivalents.

THE BUDGETARY TREATMENT OF AN INDIVIDUAL MANDATE IS UNSETTLED

In deliberating the appropriate budgetary treatment of legislation considered or enacted by the Congress, CBO and the Office of Management and Budget (OMB) normally consult two sources for guidance. One is the 1967 *Report of the President's Commission on Budget Concepts*, which stated the purposes of the federal budget, articulated principles of budgetary classification to achieve those purposes, and made recommendations about the budgetary treatment of specific federal activities. The other source is the current budgetary treatment of comparable federal actions. Unfortunately, these sources provide no definitive answer to the question of the appropriate budgetary treatment of a mandate that all individuals purchase health insurance. Because such a mandate would be unprecedented, there are no closely analogous federal actions. More important, because policymakers have only recently proposed an individual

1. Congressional Budget Office, *An Analysis of the Administration's Health Proposal* (February 1994), ch. 3.

mandate in the context of national health care reform, the President's Commission on Budget Concepts did not have to apply its general recommendation of a comprehensive, unified budget to the specific case of an individual mandate.

In its report, the commission observed that its recommendation "poses practical questions" concerning precisely what transactions the budget should include.[2] A careful reading of the report indicates that the commission focused on whether particular federal "programs" should be included or excluded from the budget. Although the report never explicitly defined the term "programs," it seems to refer solely to the activities of entities created by federal law.[3] The report makes a general distinction between resource allocation decisions that involve "private choice," are made "in a decentralized fashion," and are "subject to the economic disciplines of the marketplace," and resource allocation decisions that are made in a centralized fashion at the federal level by "the President and the Congress" through "the governmental budget process." [4] Because the commission focused on entities created under federal law, it did not have to consider whether the budget should ever record any of the transactions

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2. The President's Commission on Budget Concepts, *Report of the President's Commission on Budget Concepts* (October 1967), ch. 3, p. 24.

3. Ibid., p. 25. The report states that "it quickly became clear to the Commission that the problem of defining the Federal Government's scope, for the purposes of this report, centered on whether a few key agencies and programs should be included or excluded."

4. Ibid., pp. 24, 25.

of individuals or of entities not created under federal law, and it did not have to apply its distinction between private and public resource allocation decisions to such transactions.

In the quarter century since the publication of the commission's report, deliberations about the appropriate budgetary treatment of legislation have generally focused on whether the transactions of new federal agencies or programs belonged in the budget. Most budget analysts have assumed that the budget should include only the transactions of federal agencies. When the activities of a nominally private entity are equivalent for all practical purposes to those of a federal agency, OMB and CBO may deem the entity to be a federal agency and record its transactions in the budget. That was the logic behind CBO's conclusion that the budget should include the health alliances that would be created by the Administration's Health Security Act.

In the absence of guidance from the *Report of the President's Commission on Budget Concepts* or budgetary precedents, policymakers should determine the appropriate budgetary treatment of an individual mandate to purchase health insurance. A decision on this issue would also apply to any legislation that required all individuals to obtain health insurance from the private sector or through a government program *and* mandated that all employers pay some or all of the cost of the coverage that their workers

obtained. Such a bill would have the same fundamental policy objective as the individual mandate. Thus, it would be reasonable to treat the employer mandate in such legislation as simply an administrative mechanism for carrying out the individual mandate.

Policymakers would have to address two related issues in order to determine the budgetary treatment of an individual mandate: Is it ever appropriate to include in the budget any payments that individuals make to private firms? And if so, which such payments should be included?

SHOULD THE COSTS OF COMPLYING WITH AN INDIVIDUAL MANDATE BE INCLUDED IN THE FEDERAL BUDGET?

The federal budget could record estimates of the costs of complying with an individual mandate to purchase health insurance. In that case, the budget would include estimates of the amounts that nonexempt individuals and families would have to spend each year to purchase the required insurance coverage from qualified health plans. The costs would be recorded as both budgetary receipts and outlays, consistent with the compulsory nature of the purchases.

Arguments for Including the Costs in the Budget

One argument in favor of including the costs of complying with an individual mandate in the budget is that the transactions would be predominantly public in nature. From this perspective, the essence of private choice is the ability *not* to act. Decisions about resource allocation are not private unless individuals can choose not to spend their money in response to market forces. The government would exercise a much greater degree of control over the purchases required by an individual mandate than it does over any transactions in other federally regulated markets, simply because individuals could not pass up buying health insurance from qualified private health plans or enrolling in a government health program. This difference in the degree of federal control would make the purchases of private health insurance predominantly public transactions. The private aspects of the purchases--the influence of market forces on premiums, the ability of individuals and families to choose among health plans and between types of coverage, and the fact that the health insurance market would function in a manner analogous to other federally regulated markets--would not outweigh the high degree of federal control. Because the transactions would be predominantly public, they would belong in the budget even though individuals and private firms, not federal agencies or their practical equivalent, would conduct them.

A second argument, closely related to the first, reasons that any mandatory portion of the premiums would meet the definition of governmental receipts.[5] The commission's report recommended that payments received by the government as a result of "activities that are essentially governmental in character, involving regulation or compulsion, should be reported as receipts." [6] The General Accounting Office, which is required by law to publish standard definitions of terms used in the federal budget process, defines receipts as "[c]ollections from the public based on the government's exercise of its sovereign powers." [7] The mandatory portion of the health insurance premiums paid by individuals and families not enrolled in government health programs would be compulsory. Because the mandatory portion would result from an exercise of the federal government's sovereign power, it would be essentially governmental in character and would meet the definition of receipts. The fact that private firms would collect the premiums directly, rather than receive them from a federal agency that had collected them, would not alter the fact that they resulted from public, rather than private, decisions about resource allocation.

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5. It should be noted that not all health insurance premiums would fit the definition of governmental receipts. It is possible that some premium payments could be voluntary and therefore not subject to inclusion in the federal budget. For example, payments for supplemental insurance to cover the cost of health services beyond those required in a guaranteed national benefit package would not meet the definition of governmental receipts.

6. The President's Commission on Budget Concepts, *Report of the President's Commission on Budget Concepts*, p. 65.

7. General Accounting Office, *A Glossary of Terms Used in the Federal Budget Process: Exposure Draft* (Revised January 1993), p. 27.

Accordingly, the flows should be recorded in the budget as federal receipts and outlays.

According to a third argument, the federal budget would be preserved as a comprehensive measure of the amount of resources allocated to the public sector through collective political choice at the national level. An individual mandate of this kind would transform the purchase of health insurance from an essentially voluntary private transaction into a compulsory activity mandated by federal law. Failure to record the cost of this compulsory activity in the budget would open the door to a mandate-issuing government taking control of virtually any resource allocation decision that would otherwise be left to the private sector, without the federal budget recording any increase in the size of government. In the extreme, a command economy, in which the President and the Congress dictated how much each individual and family spent on all goods and services, could be instituted without any change in total federal receipts or outlays.

Arguments Against Including the Costs in the Budget

There are at least three arguments against including in the budget the costs of complying with an individual mandate. First, critics say that those costs would

not flow through federal agencies or other entities established under federal law. From this perspective, the *Report of the President's Commission on Budget Concepts* was correct in focusing deliberations about budgetary classification on entities created under federal law. It would not be appropriate to include in the budget the costs of buying the coverage required by the proposal, because individuals and families would not purchase health insurance from entities created under federal law. The budget should record only payments that individuals and families make directly to federal agencies or to agents of the federal government.

Second, excluding the costs of the individual mandate would be consistent with the current practice of excluding from the budget the costs to private firms of federal regulatory mandates. Just as firms usually have many ways of complying with regulatory mandates, individuals could exercise considerable discretion about how they fulfilled their obligation to purchase health insurance. They would have a choice among several plans. In addition, the market for private health insurance would function in a manner analogous to other markets--those for local and long-distance telephone service, for example--that are highly regulated by the federal government. The premiums charged by each plan and the enrollment and coverage decisions of individuals and families would be subject to the economic disciplines of the marketplace. Further, the government's control over the transactions required by the mandate

would not be significantly greater than its control over the transactions that private firms must conduct to comply with federal regulatory mandates.

Third, excluding the costs of the required purchases of health insurance from the budget is appropriate because the amounts could not be directly observed. The federal government would have to estimate how many people had not enrolled in government health plans and therefore were required to purchase private health insurance. It would also be required to judge whether individuals were required to buy comprehensive or, in some plans, catastrophic coverage, and to determine the price of the cheapest plan available in their area. These estimates would necessarily be uncertain.[8] By contrast, most budgetary transactions are cash outlays or accrued interest costs that can be measured with little uncertainty and can be easily audited.

CONCLUSION

Because a mandate that individuals purchase health insurance would be an unprecedented form of federal action, its appropriate budgetary treatment is yet

8. Critics of this argument note that much of the uncertainty surrounding estimates of total private health insurance payments could be overcome by requiring plans and self-insured employers to report enrollment levels, the premiums that they charged, and the geographic areas in which they operated. The government could use this information to produce budget numbers. In any event, critics argue that the lack of data would not justify excluding the costs of the mandate altogether from the budget. A separate budgetary category could be created to record those costs if policymakers wished to keep them separate from other budget estimates.

to be determined. To settle the issue, policymakers should decide whether including transactions between individuals and private firms in the budget is appropriate, and if so, how to draw the line between transactions that are predominantly private and those that are predominantly public. There is no self-evident way to make these judgments. It is appropriate, therefore, for policymakers to resolve the issue.

That decision would have important implications for the future of the federal budget and the budget process. It might influence decisions about health care reform and other proposals for achieving public policy objectives by imposing individual mandates. If policymakers decided that the budget should record the costs of complying with an individual mandate, that choice might also focus attention on the issue of whether the federal budget should record the costs of federal mandates that apply to businesses or to state and local governments. The argument can be made that some such mandates involve a degree of federal compulsion that is comparable to the degree of compulsion that would be involved in an individual mandate to purchase health insurance. Conversely, a decision to exclude the costs of an individual mandate to purchase health insurance from the budget could lead policymakers to impose other mandates on individuals and, in the extreme, to use mandates to control the allocation of a large portion of the nation's resources without the cost of those actions being controlled through the federal budget process. In conclusion,

because the decision would have important implications for the budget and the federal budget process, it would be prudent to debate and decide the issue while any health reform legislation that contained an individual mandate is under consideration.