REISTRIBUTIONAL ISSUES IN THE PRIVATIZATION OF GOVERNMENT INSURANCE PROGRAMS

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My presentation today is largely descriptive rather than normative. I shall say a few words about the privatization notion itself and then examine some of the redistributional issues that arise in considering the privatization of government insurance programs.

I. The Privatization Notion

Privatization of a government program is generally believed to constitute an enhancement of individual liberty because it involves the transfer of some functions performed by government to the private sector. In fact, however, different kinds of "privatization," broadly conceived, may have quite different effects on individual liberty. For example, we could displace some of the command and control regulation of environmentally risky activity that now occurs under the federal environmental laws1 with emission taxes or a system of marketable permits that would allow the market to allocate pollution rights.2 But if the emission taxes contained in such a program were set very high, this kind of privatization would enhance economic liberty on paper only. Perhaps this approach would be sensible or perhaps it would not, but we should not mistake its real character by focusing on the fact that it involves more private and less governmental decision-making.

Similarly, tort law can be understood as a private version of governmental regulation of safety, since it leaves decisions regarding the appropriate level of care to the individuals and enterprises that are threatened with liability. Yet as we have seen during the past several years, the tort system has been increasingly directed toward the socialization of risk. The idea that "market" control over private activity, as such control is exercised through the tort system, somehow enhances liberty is at the least an oversimplification of what may happen when certain functions are transferred from government

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2. For an example of such suggestions, see Ackerman & Stewart, Reforming Environmental Law, 37 Stan. L. Rev. 1333 (1985).
to the private sector. There are very different kinds of privatization, and it is necessary to evaluate them comparatively rather than focus on the transfer of functions alone.

II. PRIVATIZING GOVERNMENT INSURANCE

A form of privatization in which I have a special interest is governmental insurance programs. What I have to say is intended to be more descriptive and analytical than normative. I do not have a general position about whether these programs should be privatized. Instead, I want to generate several hypotheses about the role played by redistributional motives in these programs and about the impact of these motives on the prospects for successful privatization of the programs.

The first point worth noting is that, along the public/private spectrum of insurance programs, redistribution plays a much larger role in the public programs and a smaller role in the semi-public and privatised programs. One might even define these as public programs by the degree of redistribution they entail. Since redistribution plays such a substantial role in public insurance programs, simple methods of privatizing them while still retaining the redistributional elements probably are not feasible.

When critics of government insurance programs, such as Professor Priest, note the inefficiencies present in such programs they are entirely accurate, but in at least one sense their criticisms are beside the point. The government insurance programs may well be inefficient precisely because they are designed to contain redistributional elements that are necessarily inefficient. When prospective beneficiaries do not pay premiums in proportion to the risk they pose, adverse selection into optional programs is a likely result. When the deductibles and coinsurance that mitigate moral hazard in private insurance are omitted from a governmental insurance program, the cost of the program is likely to rise because beneficiaries do not take optimally protective actions to avoid incurring insured losses. The reason government insurance programs often assess level premiums and use little or no coinsurance or deductibles is because they are intended in part to achieve a redistribution of risk or wealth that is inconsistent with using varying premiums or coinsurance. If this produces the inefficiencies characteristic of adverse selection and moral hazard cited by critics of these programs, that is an unhappy, but perhaps necessary side effect of the programs.

Two subsidiary phenomena also seem to be characteristic of the government insurance programs that have the redistributitional aims just described. First, in many insurance programs there is an effort to fashion premium and benefit structures to avoid even more redistribution than is intended; second, often there is also an effort to camouflage the redistribution that is actually effectuated by the programs. Both phenomena may well reflect the ambivalence that even the supporters of the programs feel about the redistributions that the programs accomplish.

Let me provide several examples. Certain aspects of public insurance programs such as Medicare and the Social Security Disability insurance system are heavily redistributitional, but these programs are also partially contributory. Potential beneficiaries may not pay premiums in proportion to their risk of loss; however, they do pay what amounts to premiums as part of their undifferentiated social security contributions. The contributory feature of these programs involves a kind of mandatory risk-spreading, at least in the case of social security, that forestalls what might well be an even greater demand for redistribution if the programs were not partially contributory.

Many of the working poor who become eligible for Social Security Disability, for example, would have no access to disability insurance if they had not made mandatory social security contributions. In such cases society might feel compelled to provide even more direct and substantial subsidies to the disabled than the current partially contributory system provides. Similarly, imagine the demands that might be placed on public hospitals to provide uncompensated care to the elderly if the Medicare program was not in place. In contrast, Professor Ellickson has suggested that if we were to move all the way to privatization and arrive at “anarchy,” then additional wholly private forms of philanthropy would grow up. In his view, the partial redistributions implemented by the current system prevent these more private forms of distribution from developing. He may be correct, but I suspect that at least part of what fuels the current system is the fear that he is wrong.

The other interesting feature of many government insurance programs is that they tend to camouflage their redistributitional features by calling themselves insurance. The partially contributory aspect of most of these programs makes it logical to give them this name, but it also makes it possible to underemphasize the degree of redistribution they accomplish. What kind of true insurance program, for example, would be subject to the periodic debates

5. For a discussion and critique of Medicare, see Ferrara, Medicare and the Private Sector, 6 Yale L. & Pol’y Rev. 61 (1988).
6. See Ellickson, The Legal Dimension of the Privatization Movement, infra p. ___.
that embroil the current social security system about whether it should be a pay-as-you-go or an actuarially fair system?

The fact that the redistributions these systems accomplish is to some extent camouflaged, however, may also place a practical limit on the feasibility of privatizing them. To retain the redistribution while simultaneously privatizing, the redistribution would almost certainly have to be more open. Purchase of the new, "private" insurance would have to be mandatory. Premium subsidies would have to be provided to beneficiaries to finance the redistributational component of the program, either in the form of "insurance stamps" or an openly wealth-oriented premium structure. Of course, such open subsidies would then become controversial, and one goal of the program would be undermined. Undermining redistributational goals in this manner undoubtedly is one of the aims of many proposals for privatization, though often the debate about whether to privatize proceeds as if the redistribution produced by government insurance were unintended rather than having been a goal from the outset.

On the private side of the insurance divide there is also a form of camouflage, redistribution, in this case occurring in the name of regulation. For example, there is increased regulation lately in the manner in which insurance companies classify risk. Some states have mandated unisex classifications in auto or life insurance; in other states there is mandatory experience rating in certain lines of insurance. Risk classification is a method of dealing with the problem of adverse selection and, to some extent, with moral hazard.7 All governmental regulation of insurance classification is in some sense redistributational, because the market on its own reaches an optimal level of classification. Mandatory experience rating, for instance, does not necessarily move classifications closer to the real level of risk posed by policyholders who suffer losses; it may simply redistribute risk from those who are unlucky enough to have accidents to those who are lucky enough not to have them.

These and other redistributions through the regulation of insurance classification are rarely described that way. Typically they are explained as efforts to prevent insurance companies from interfering with peoples' rights as individuals, as in unisex classification requirements, or to assure more accurate classification and charging. Yet, unless there is a major imperfection in the market for insurance that precludes accurate classification, such regulation involves redistribution, whether it is called that or not. This too is camouflage. The principal alternatives are not to redistribute at all or to do so more openly, through subsidies of one sort or another. Even the proponents

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of redistribution through regulation of risk classification, however, might be ambivalent about providing the open subsidies that would substitute for the camouflage that is part of the regulatory approach.

**CONCLUSION**

I do not propose to draw profound lessons from this analysis, for my aim has mainly been to uncover and isolate some redistributional issues that already are fairly close to the surface of debate about whether to privatize government insurance programs. The main insight I offer is that, because of the ambivalence I have ascribed even to the proponents of redistribution, one can probably observe a tendency for such programs to embody the least redistributional scheme that still satisfies the aims of the proponents. Sometimes these aims will require a government insurance program, while in other settings a “private” scheme with redistributional features is capable of doing the job. An entirely different question, of course, is whether insurance programs designed to be both efficient and redistributional can ever be very good at achieving either aim.