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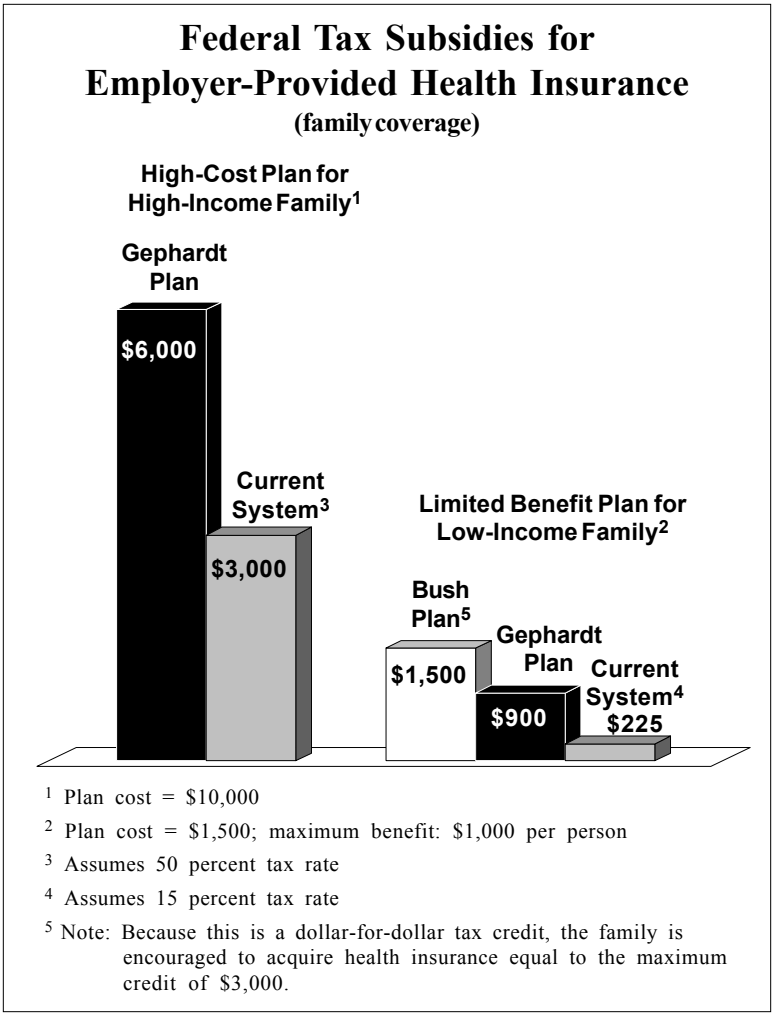
Gephardt's Health Plan: Four Flaws

by John C. Goodman and Devon M. Herrick

Rep. Richard Gephardt (D-Mo.) recently unveiled the centerpiece of his presidential campaign: a plan to encourage near-universal health coverage. The plan calls for replacing the existing system of federal income tax subsidies for health insurance with a much more expensive system. Employers would receive refundable tax credits for 60 percent of the cost of employee health insurance, leaving employees to pay, at most, the remaining 40 percent. Such government programs as Medicare, Medicaid and the children's health insurance program (CHIPs) would be expanded. Gephardt would pay for his plan by rescinding virtually all of President Bush's tax cuts. Why is this the wrong solution to the problem of the uninsured in America?



Wrong Subsidy. Under the current system, employer payments for employee health care are excluded from the taxable income of employees — a federal subsidy that amounts to more than $125 billion per year. Gephardt's plan combines this amount with new spending to provide a different system of tax subsidies totaling $213 billion the first year and increasing to $247 billion by 2007. Most of this money would simply reimburse employers for the benefits they already provide to 177 million people (workers and their dependents).

Initially these funds would be a boon to employers. However, over time, most of the benefit of the subsidies would be passed on to the employees as higher wages to replace the employers' (now lower) after-tax cost of health insurance. At least this would happen in competitive labor markets. In regulated markets, unionized industries and government entities, workers probably would not get all the benefits. But why bother with this exercise? If the goal is to reward employees for having health insurance, why not give them a break on their personal income tax returns?

The principal problem with the current system is that the tax law subsidizes employer-provided health insurance but gives virtually no tax relief to people who buy insurance on their own. Gephardt's plan would continue and worsen this inequity. Although it would encourage more small firms to offer health care coverage, this multibillion-dollar program would do nothing for those who must buy their own health insurance.

Gephardt claims his plan would insure an additional 30 million people. If so, the price is high. Each newly insured individual would cost taxpayers about $3,710 or almost $15,000 for a family of four. And what if the plan is less successful? Currently, almost 14 million people decline coverage by employers, almost all of which would pay more than half the

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cost. Many are no doubt influenced by the fact that the national safety net makes available, on average, about $1,000 in annual free care for each uninsured individual. If only half of uninsured workers got coverage under the Gephardt plan, the cost per newly insured family of four would rise to $30,000.

Wasteful Subsidy. A second problem with the current system is that it allows people to substantially reduce their taxes by buying more insurance. This encourages people to overinsure in wasteful ways. For example, employees and employers pay only about 70 percent of the cost of premiums after tax, on the average. This gives them an incentive to purchase coverage until the last (marginal) dollar of insurance is worth only 70 cents. Gephardt's plan would give them an incentive to increase their coverage until it is worth only 40 cents on the dollar. These incentives would encourage health plans with all the bell and whistles — acupuncture, massage therapy, etc. — all subsidized by taxpayers.

Unfair Subsidy. A third problem with the current system is the vast differences among companies and within companies in amounts spent on health insurance, all of which the tax law subsidizes indiscriminately. The Gephardt plan would worsen this problem. For example, at fast food and retail companies such as Wal-Mart, McDonald's and Lowe's, some employees can acquire limited-benefit insurance costing only $350 per year. These health plans — often providing no more than $1,000 in benefits per year — are quite popular in workplaces where wages are low and employees have few options. At the same time, some executives have very rich plans that cost $10,000 per year, with the employer often paying all deductibles and copayments. Gephardt would reward the fast food workers with a subsidy of $210 and the top brass with a subsidy of $6,000.

Regressive Subsidy. A fourth problem with the current system is that it rewards people based on their tax bracket. The right to exclude insurance from taxable wages is worth far more to someone in the 50 percent bracket than to someone in the 15 percent bracket. The Gephardt plan would give everyone with the same insurance the same subsidy. This is a welcome change. But because the plan bestows more subsidies on people with richer plans, it could be even more regressive than the current system. In the example above, Gephardt would reward executives with a subsidy that is $5,790 more than the one for the fast food worker. Under the current system, the likely tax subsidies are $3,000 and $32, respectively.

Gephardt vs. Bush. Many health economists have recommended replacing the current system with tax credits to encourage private health insurance. President Bush has proposed using a tax credit for low-income workers.

The Bush reform plan is more narrowly focused than the Gephardt plan. The Bush plan directs money to those who need it rather than to those who do not. [See the figure.] In principle, however, Bush's plan could be expanded to completely replace the current system, much as Gephardt's intends to do. Ignoring differences in the price tag, the design of the Bush plan is much better because it avoids each of the four flaws in Gephardt plan and in the current system. Specifically, the Bush plan:

- Provides relief to individuals, not to their employers, and initially directs this relief to uninsured individuals who must purchase their own insurance.
- Subsidizes the first dollars of coverage, rather than the last — having government pay for basic catastrophic coverage while individuals pay out of pocket for extra benefits.
- Provides the same tax relief to everyone, regardless of how wasteful or frugal their insurance is.
- Provides more relief to low-income than to high-income families.

Gephardt's Democratic rivals have complained that his plan costs too much. But its cost is not the only problem. The design of his plan is fundamentally flawed.

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