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Personal and Portable Health Insurance

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One of the peculiarities of the U.S. health care system is that the health plan most of us have is not a plan that we chose; rather, it was selected by our employer. Even if we like our health plan, we could easily lose coverage because of the loss of a job, a change in employment or a decision by our employer. These problems affect all Americans, but have the greatest impact on older workers, who are more likely to have health problems.

President Bush has proposed making health insurance individually-owned, personal and portable, traveling with employees from job to job. It is an idea whose time has come.

Problem: Lack of Continuity of Insurance. Virtually all employer health insurance contracts last only 12 months. At the end of the year, the employer — in search of ways to reduce costs — may switch health plans or cease providing health insurance altogether. The only people with private health insurance guaranteed to last longer than one year are people who purchase insurance on their own.

Problem: Lack of Continuity of Care. Employer-sponsored health care largely evolved when most health insurance was fee-for-service — which meant employees could see any doctor or enter any hospital and insurance paid all or most of the bills. As a result, a change of jobs usually did not cause undue disruption, provided that both the new and old employer had health insurance plans.

Things changed after the introduction of managed care. Today, employees who switch jobs must not only switch health plans, they often must change doctors as well, since each plan tends to have its own network. Additionally, different plans have different benefit packages. Thus some services, like mental health, may be covered under one employer's plan but not under the next employer's plan.

These disruptions affect some families more than others. For healthy people, they may amount to minor inconveniences. But if an employee (or a member of the employee's family) has a health problem, there may be an interruption in the continuity of care. One study of chronically ill workers found that those who rely on their employers for health coverage have less job mobility: They are 40 percent less likely to change jobs compared to similar workers who obtain health coverage elsewhere.

Problem: Perverse Incentives for Employers and Employees. Most employees view health insurance as a fringe benefit and primarily search for employment opportunities that reward them for their skills and abilities. But there is a growing minority of workers who approach the job market very differently. They have a family member (often a spouse or child) who has very high health care costs. When these workers compare job opportunities, they are primarily comparing health plans. For them, health insurance is the main attraction, rather than the job or the pay.

Clearly it is not in the financial self interest of employers to attract workers whose primary motivation is to get their medical bills paid. So, to protect themselves from such potential hires, employers are increasingly altering their health plans to attract the healthy and avoid the sick. Having small copayments for routine office visits and higher deductibles for hospitalization is one technique. Having long waiting periods before employees become eligible for the company's health plan is another.

These are rational responses by employers to a labor market that increasingly resembles a game of musical chairs. But what is good for the employer is not necessarily good for society.

Problem: Younger Spouses and Retirees on Medicare. The lack of individually-owned, portable insurance is particularly burdensome for many women who are married to older men. When husbands retire and enroll in Medicare, wives can be left without any coverage because Medicare won't allow enrollees to sign up underage spouses. If the couple has to purchase her insurance until she reaches 65 and also qualifies for Medicare, they have to do so with after-tax dollars. She will also be at a time in her life when she's charged higher premiums, since health risks tend to rise with age. And she'll pay even more (or possibly be denied insurance altogether) if she already has an expensive health problem or is recovering from a disease such as breast cancer.

Source of the Problem: Tax Penalties for Portable Insurance. Tax law is the main reason companies provide workers with health insurance rather than pay

higher wages with which employees could buy their own insurance. People receiving employer-based health insurance enjoy an enormous tax advantage. Employer-paid premiums avoid federal, state and local income taxes, as well as the (FICA) payroll tax. By contrast, people who buy their own insurance get no tax break unless their medical costs exceed 7.5 percent of their adjusted gross income. Even then they get only a simple deduction and must itemize on their tax return. As a result, genuinely portable insurance is actually penalized under the tax law.

For a typical middle-class family, government effectively pays half the cost of employer-provided health insurance. To see what this means, suppose insurance for the family costs $6,000. If the insurance is purchased by an employer, it can be purchased with pretax dollars. This implies that the employee must earn $6,000 to set aside as pretax payment for insurance rather than as taxable wages. However, if the family directly purchased the insurance, the employee would have to earn $12,000 in order to have enough left over after paying taxes to purchase the insurance. In terms of the amount of pretax income needed to buy it, insurance purchased directly with after-tax dollars costs the family twice as much!

Source of the Problem: Federal Laws. Under the current system, employers cannot buy individually-owned insurance for their employees. Specifically, lawyers interpret the Health Insurance Portability and Accountability Act of 1996 (HIPAA) to say that the only employee health insurance employers can purchase with pretax dollars is group insurance. Ironically, the law that was designed to encourage portability effectively outlawed it.

Creating Personal and Portable Health Insurance. Just because employers pay all or most of the premium does not mean that health insurance must necessarily be employer-specific. As an alternative, why can't employees enroll in health plans that meet their needs and stay in those plans as they travel from job to job?

Employers should be able to buy personal and portable insurance for their employees. Even though employers initially would pay the premiums (as they do today), this insurance would be owned by the employees and would travel with them as they move through the labor market. Thus employees would get portability (a characteristic of individual insurance), but they would get it for premiums that are closer to the cost of group insurance.

Although employers would initially buy all of their employees into the same health plan, with the passage of time some of those employees will leave and go to work for other firms. Employers will also hire new employees who are members of other plans. And in most cases the employer's initial group of employees will be able to switch to other plans after a transition period. Indeed, it is possible that every employee will be in a different plan.

A Transition Plan. Some years ago, the National Center for Policy Analysis and Blue Cross/Blue Shield of Texas proposed a detailed plan to transition from group insurance to personal and portable insurance. [See http://cdhc.ncpa.org/news/making-health-insurance-portable.] This plan could form the basis for President Bush's nationwide proposal.

Advantages of Portable Insurance. Portable health insurance promises a continuing relationship with an insurer and, therefore, a continuing relationship with doctors and health facilities. It also promises that if people like their health plan, they will be able to stay in it — without worrying about an employer's decision or a change in employment.

For employers, portable health insurance means that small groups are no longer treated as self-contained pools and rated each year based on changes in the health status of their employees. Instead, their employees will be members of very large pools in which no one can be singled out because of a sudden, large medical expense, and premium increases are the same for all. Employers can limit their contribution to a fixed-dollar amount. New hires will know how much the employer is going to contribute to health insurance, just as they know the amount of their salary. Because the employer's role is largely financial, in a real sense employers will get out of the "business" of health insurance.

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