



BRIEF ANALYSIS

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The Bush Health Plan

by **John C. Goodman**

President Bush made two bold health policy proposals in his State of the Union message. First, he proposed to replace the existing system of tax subsidies for private health insurance with a standard health deduction (like the standard deduction for dependents). In the process, he would level the playing field between health insurance purchased by individuals and employers, while eliminating tax law provisions that reward waste and penalize economy in the purchase of health insurance. Second, the president proposes to allow the states to redirect federal funds that currently pay for free health services for the uninsured toward private insurance subsidies instead.

Leveling the Playing Field between Employer Purchase and Individual Purchase. The federal government subsidizes employer-provided health insurance through the tax system. The employer's premium payments avoid federal, state and local income taxes as well as payroll (FICA) taxes. For example, a middle-income

family avoids a 25 percent federal income tax, a 12.6 percent FICA tax and state income tax of 5 percent or more. [See the figure.] In some places, the government is effectively paying half the cost of the insurance.

The tax law is far less generous to people who must purchase insurance on their own. Although self-employed people can deduct their health insurance, they get no relief from the payroll tax. The only tax relief available to other individual purchasers is the ability to deduct expenses exceeding 7.5 percent of income.

Most people who are uninsured have no opportunity to obtain employer-provided insurance with pretax dollars. Thus, the uninsured must pay up to twice as much after taxes for the same coverage if they choose to insure.

The current system is unfair in other ways. Families with the most expensive health care plans tend to have the highest incomes. As a result, the bulk of federal tax subsidies tend to go to those who need them least. On the average:

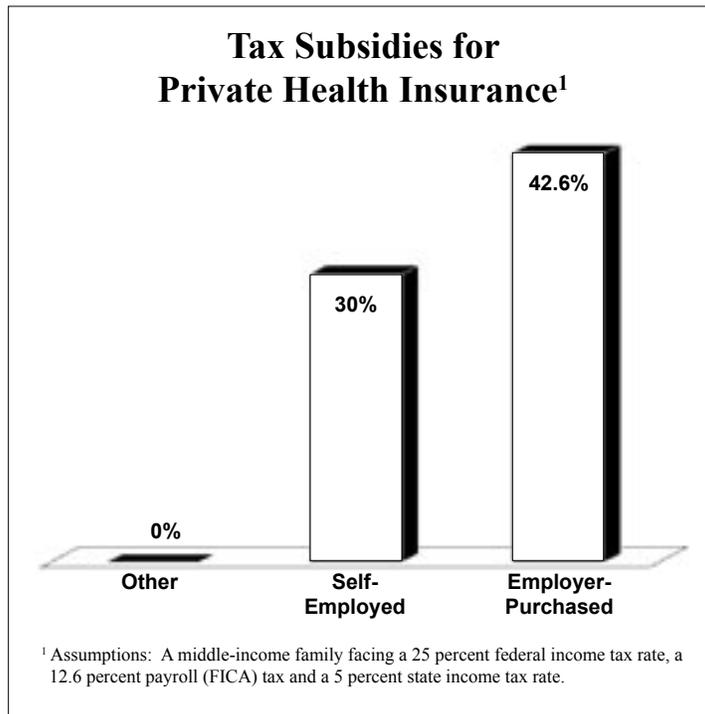
■ Households earning more than \$100,000 per year receive an average subsidy of \$2,780.

■ By contrast, those earning less than \$30,000 receive only \$396.

President Bush's plan treats everyone at the same income level equally under the tax law. It makes employer-provided health insurance count as taxable income. However, it also provides a standard tax deduction of \$15,000 for families and \$7,500 for individuals who have insurance, regardless of how that insurance is purchased and regardless of the cost of the insurance. Wage earners, for example, will be able to avoid income and Social Security taxes on the first

\$15,000 or \$7,500 of earnings as long as they have minimal coverage.

Eliminating Subsidies for Wasteful Purchases. Under the current system, the government subsidizes wasteful health insurance. Since there is no limit on the exclusion for employer-provided health insurance, the subsidy applies to all insurance — no matter how lavish or extravagant. Conversely, employees who choose more economical health insurance, so they can have more take-home pay, are taxed on their gains. Under the



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Bush proposal, no one would be able to reduce his or her taxes by buying more expensive insurance. This means employers and employees will be unlikely to spend an extra dollar on insurance unless they get a dollar's worth of value.

Perverse incentives will be eliminated because the Bush tax subsidies are fixed sums, and not based on the amount spent. As a result, people who are conservative and prudent in choosing a health plan will reap considerable tax rewards.

Suppose you get family coverage from an employer and the cost is \$5,000. Under the current system you are getting a tax subsidy. Under the proposed new system, you get to exclude \$15,000 from taxation. So your tax break would be three times as high. You will pay higher taxes only to the extent your insurance costs are greater than \$15,000 (only 20 percent of households, according to the White House).

Leveling the Playing Field between Private Insurance and Charity Care. The National Center for Policy Analysis estimates that year-round uninsured people in this country get about \$1,500 of free care per year, on the average. That equals \$6,000 for a family of four. As a result, the current system encourages millions of people to be uninsured. Why pay for expensive private health insurance when free care provided through public programs is de facto insurance?

Yet society should not be indifferent about this decision. For one thing, the choice to rely on safety net care is a choice to be a "free rider" at the taxpayers' expense. For another thing, the two types of care are not equivalent. The privately insured patient has more choices of doctors and hospital facilities. Further, safety net care is generally much less efficient. For instance, uninsured patients often use emergency rooms to provide care that is more economically provided in a free-standing clinic. As a result, per dollar spent, the privately insured patient typically gets more care and better care. For that reason alone it is in society's interest not to encourage people to be in the public sector rather than the private sector.

President Bush's plan proposes to allow states to redirect about \$30 billion of federal funds that currently fund care for the uninsured and use them instead to help people buy private health insurance. Gov. Mitt Romney's plan in Massachusetts is an example of the type of innovation that would be permitted.

Meeting the Special Needs of Baby Boomer Retirees. The 77 million members of the baby boomer generation will begin becoming eligible for Medicare in 2011. Almost 80 percent will retire before they reach the age of 65, however, whether they plan to or not. Even those husbands who successfully postpone retirement until age 65 will likely have wives who are younger and not eligible for Medicare. Most of these early retirees will not get post-retirement insurance from an employer. As a result, they will turn to the individual market where the premiums for 60-year-olds are three times that of 20-year-olds and (under the current system) they will have to pay with after-tax dollars.

The Bush plan offers them welcome tax relief.

Paving the Way for Personal and Portable Insurance. The Bush plan may also have the added benefit of paving the way for personal and portable insurance. Individual insurance has the virtue of portability—people can take their coverage with them as they move from job to job. 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 benefit decisions or a change in employment.

Conclusion. President Bush's health care proposals would help remove some of the distortions that have plagued the health insurance market for nearly 60 years. As a result, more people would be insured, the insurance they have would better suit their needs, and fewer people would rely on the social safety net.

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