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Answering the Critics of the Bush Health Plan

by John C. Goodman

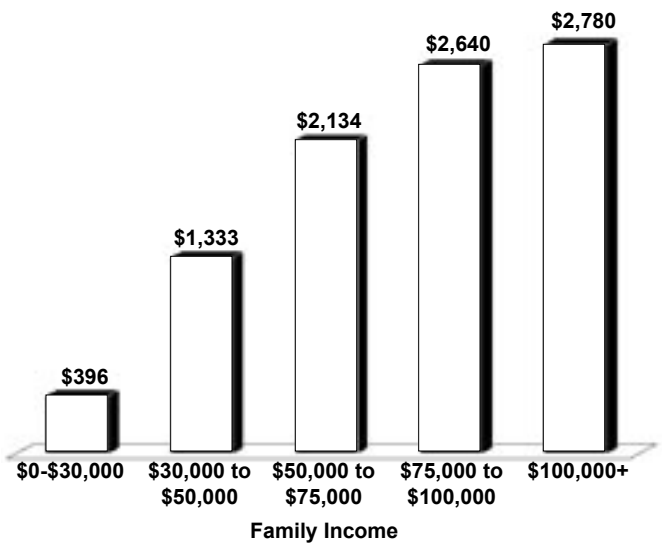
President Bush made bold health policy proposals in his State of the Union message. First, he would level the playing field between individual and employer purchase of health insurance. Second, he would eliminate provisions in the tax law that reward waste and penalize economy in the purchase of health insurance. Third, he would allow the states to redirect federal funds used for charity care and use them to subsidize private insurance instead.

The plan has drawn praise from the right and the left. It gets high marks from the Urban Institute and the Brookings Institution, as well as the Heritage Foundation and the American Enterprise Institute. Yet the critics have been quite vocal. Let's look at their complaints.

Is the Bush Plan a Sop to the Rich? Families USA claims that the Bush health plan would benefit the rich at the expense of the poor. The same charge was made by Paul Krugman in the *New York Times* and some Democrats in Congress. But as Steven Pearlstein and Ruth Marcus explain in separate editorials in the *Washington Post,* the opposite is the case.

The Bush proposals would redistribute tax subsidies for health insurance from the haves to the have-nots. Specifically, the plan would grant everyone a health insurance standard deduction of $15,000 (family) or $7,500 (individual), regardless of the cost of the insurance or how it is purchased. Families whose insurance costs less than $15,000 would pay less in taxes than they currently pay. Families whose insurance costs exceed $15,000 would pay taxes on the excess. Thus, for the first time, people who must purchase their own insurance would receive the same tax relief as people who obtain insurance through an employer.

Under the current system, the federal government dispenses more than $200 billion a year in tax subsidies for private insurance. Families with incomes in excess of $100,000 get seven times as much subsidy as families who earn less than $30,000. [See the figure.] The Bush plan takes a large step toward a fairer arrangement.



Source: Author's calculations and data from John Sheils and Randall Haught, "The Cost of Tax-Exempt Health Benefits in 2004," *Health Affairs*, Web Exclusive W4-106-12, February 25, 2004.

According to White House estimates, about 20 percent of taxpayers — mostly those at the top of the income spectrum — would pay higher taxes. These are the 30 million people with expensive employer-provided plans. By contrast, the Bush plan will cut in half the cost of health insurance for a typical uninsured family.

Would Employer Coverage Erode? The *New York Times* complains that the Bush plan makes it easy for employees to leave their employer plan and purchase their own insurance. This exodus of employees would cause employer plans to crumble. Some business trade groups make the same complaint. Does this criticism have merit?

In virtually all group plans, employers pay half the cost of the insurance, and in the average plan, they pay three-fourths for family coverage. Even on a level tax playing field, an employee exiting an employer plan leaves three-fourths of the premium payment behind. If the employee can find a better plan for one-fourth of the premium dollars (to say nothing of the economies of group buying), the employer plan would have to be extremely wasteful.

Some employer plans may be that wasteful. If so, all would gain if the employer gets out of the health insur-

ance business and pays more wages instead. (See the next question.)

Would Employers Drop Their Health Plans? Paul Fronstin (Employee Benefit Research Institute) says, "The president's proposal would mean the end of employer-based benefits as we know them." Is this really true?

Under the Bush plan, individual and group coverage would compete on a level playing field. In such a world, employers would not offer insurance at all unless they had a comparative advantage in doing so in their competition for labor. Undoubtedly, many large companies do have an advantage — they can do for their employees things the employees cannot do for themselves. Many small firms, however, have no such advantage and would probably be better off paying higher wages instead of paying for health insurance. These issues should be resolved in the marketplace, rather than by the tax-writing committees of the U.S. Congress.

That said, where employers can add value — say, through economies of group purchase — the Bush plan creates new and stronger incentives to do so. The reason: For millions of people, the tax subsidy for purchasing insurance will be higher and the tax penalty for failure to purchase will be lower. (See the next question.)

Would the Plan Increase the Number of People with Health Insurance? Paul Krugman, Families USA and other critics claim that the Bush plan will do little to insure the uninsured.

Even if the plan failed to induce a single new person to obtain insurance, it would still be worth enacting. Tax fairness — treating equals equally under the tax law — is a worthy goal in its own right and is long overdue. Similarly, eliminating incentives to make wasteful health insurance purchases is also a worthy goal.

That said, the Bush plan will make health insurance more attractive for millions of families that are currently uninsured. The White House estimates 3 million to 4 million additional insured. That estimate is probably too conservative.

Consider a family with the opportunity to purchase a $5,000 high-deductible, no-frills health plan. Under the current system, the family would receive a tax subsidy (if purchased through an employer). Under the Bush plan, the size of that subsidy would triple. The reason: The family gets to exclude $15,000 from income and Social Security taxes, regardless of the premium cost. Conversely, the penalty (taxes owed on $15,000 instead of $5,000) would also triple if the family failed to insure.

The Bush plan is likely to encourage insurance in another way. By redistributing the benefits from the haves to the have-nots, the plan makes health insurance far more attractive to low- and moderate-income families. For example, two-thirds of the uninsured (nearly 30 million individuals) are families with incomes under $50,000. Under the current system these families receive a tax subsidy of only about one-quarter ($733) of the subsidy families earning more than $100,000 receive ($2,780). Under the Bush plan, a $15,000 standard health insurance deduction would be potentially worth $4,545 in subsidy (15 percent federal income tax and 15.3 percent payroll tax).

Would the Plan Cripple Safety Net Hospitals? Sen. Hillary Clinton says the Bush plan would take money away from public hospitals that cater to the poor. The *New York Times* agrees. Yet the White House points to Gov. Mitt Romney's health plan in Massachusetts as an example of what it wants states to be able to do; and the Romney plan was endorsed by Massachusetts hospitals, along with a huge majority of Republicans and Democrats in the state — including Sen. Ted Kennedy.

Safety net hospitals exist to provide care to indigent patients who cannot afford health insurance. These hospitals receive government subsidies to reimburse them for the cost of providing "uncompensated" care. In a market with few uninsured individuals, safety net hospitals should not need the current subsidies and would have to compete for patients against other hospitals.

Under the Bush plan, low-income families would no longer be trapped in public systems where the quality of care is frequently suspect and there is often rationing of care, especially rationing by waiting. Instead, states would be able to apply federal funds previously allocated to hospitals to subsidize the purchase health insurance for the poor.

Conclusion. While not perfect, Bush's plan would be a considerable improvement over the system we have today.

John C. Goodman is president of the National Center for Policy Analysis.