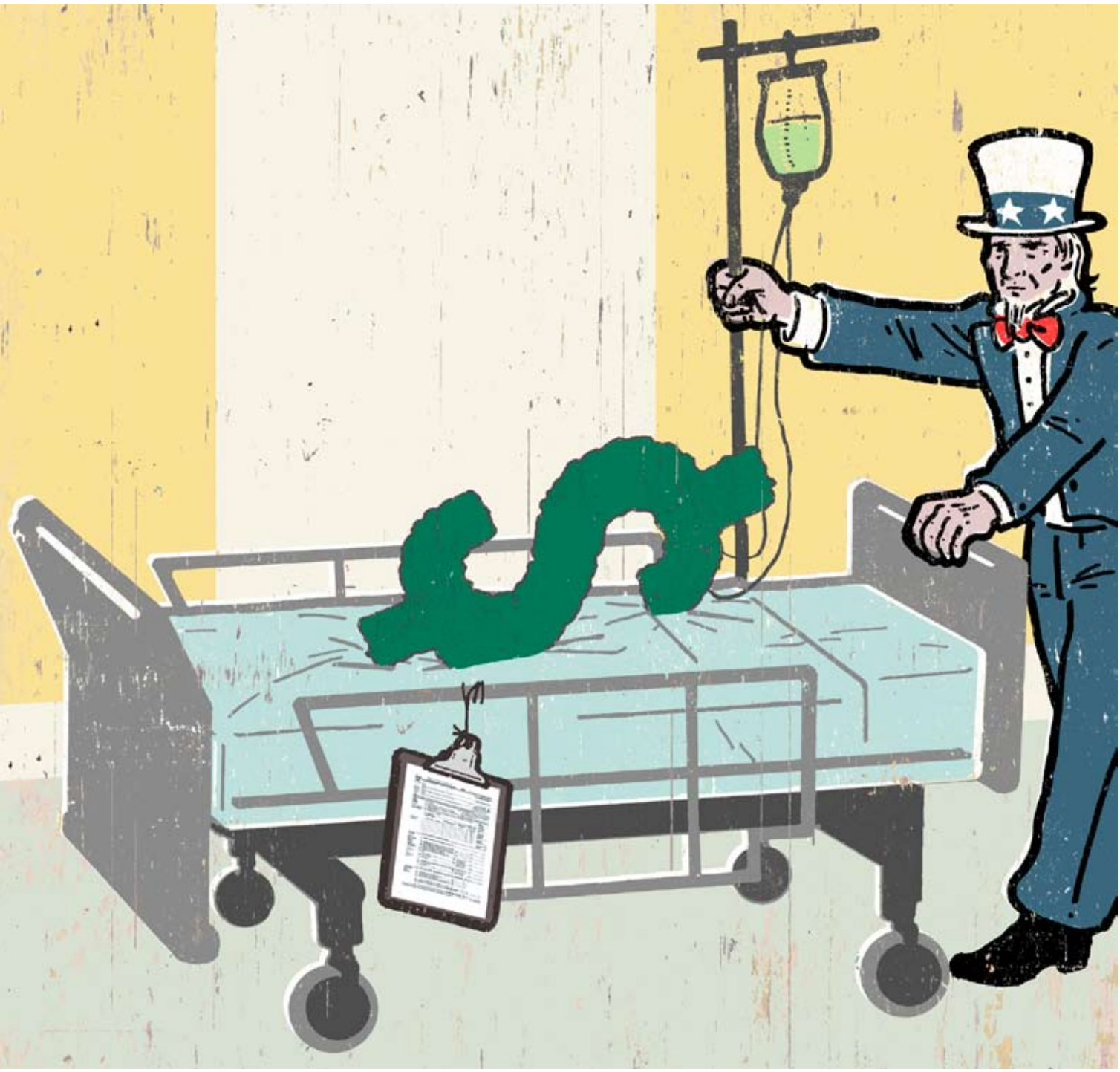
Health Insurance & Uncle Sam



To make health insurance more affordable and accessible, reform the federal tax code, says HSPH Professor of Health Economics Katherine Baicker.

Though we Americans bicker about how best to fix our health care system, on this, most agree: The system is fundamentally unfair and fails to deliver good value for our money. A national report card released in July by the Commonwealth Fund of New York, an influential health policy group, finds quality highly variable, costs rising, and access deteriorating since its first-ever report, issued two years ago.

We now spend more than twice per person what other industrialized nations do, yet we're dead last in preventing deaths through the timely, effective use of medical care, the analysis reveals. More than 47 million of us, including about one in five workers, have no health insurance whatsoever. And 28 million more have coverage the Fund's researchers call "inadequate."

The reasons are many, but a key factor—one Democrats and Republicans are talking about—is how private health insurance is financed, says Katherine "Kate" Baicker, a professor of health economics at the Harvard School of Public Health (HSPH), who from 2005 to 2007 was a Senate-confirmed member of President Bush's Council of Economic Advisers. Besides funding the public Medicare and Medicaid programs, which in 2006 cost $400 billion and $174 billion, respectively, according to Centers for Medicare and Medicaid Services, the federal government subsidizes the private health insurance to the tune of about $245 billion annually. That's a "largely hidden" fact that Baicker finds "not just extraordinarily inefficient but also highly regressive," in that it disproportionately benefits the well-paid over low-income workers.

What's unfair, she says, is that the biggest tax benefits go to the highest-wage employees who get the most generous health insurance through work and pay no taxes on the benefit, while others who must buy it on their own get no tax break. Reforming the federal tax code to "level the playing field," Baicker argues, would be one step we could take both to make health insurance more affordable and available, and to wrest a bigger bang from our health care buck.

Of course, some Americans shout that what we really need is a complete overhaul—a single-payer system, like the U.K.'s or Canada's, at one extreme, or bolder free-market solutions at the other. The political reality, Baicker warns, is that voting Americans aren't ready for big changes like these—and that "neither extreme is likely to produce the high-value care we should expect from our system."

NO SYSTEM AT ALL

During her two years in Washington, Baicker helped shape the President's 2007 plan to revamp the way the tax code subsidizes private health insurance. She says the current system is driven by the fact that employment-provided insurance plans aren't taxed like wages. This subsidy wasn't part of any well-reasoned scheme; rather, it's a "relic" of the World War II era. Some employers began offering health insurance as a new kind of perk to lure workers after the federal government imposed controls on the customary bait—wages—and ruled that workers would pay no taxes on those benefits.

Today, workers who get health insurance through their jobs still don't have to pay taxes on those benefits, but people buying insurance on their own do. They must use their after-tax earnings to shop for nongroup insurance, or pay

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Dan Page

ECONOMICAL Formerly a member of President Bush's Council of Economic Advisers, HSPH's Katherine Baicker now serves on the Institute of Medicine's Committee on Health Insurance Status and its Consequences.

for care out-of-pocket without seeing any tax relief for these expenses. This is particularly regressive, since high-wage workers are more likely to get insurance through their jobs, more likely to have very expensive insurance packages, and are in the highest tax bracket (and consequently get the most benefit out of paying with pre-tax dollars).

As if this inequity weren't bad enough, the policy also increases spending on low-value care, Baicker says. "Our tax dollars end up subsidizing costly broad-coverage plans more heavily than basic plans, and we have evidence that this promotes inefficient use of resources and dulls the incentive to create cost-saving technologies." The tax penalty for cost-sharing is one of the reasons health insurance doesn't look like auto insurance or homeowners insurance and ends up driving up quantity, not quality.

A 2004 study in *Health Affairs* by Baicker and Harvard Kennedy School colleague Amitabh Chandra suggested that spending more money is no guarantee of high quality care. Medicare beneficiaries in parts of the country where more money was spent on their care were less likely to get high-quality care—even after accounting for differences among patients and despite the fact that all had the same insurance coverage.

LEVEL THE PLAYING FIELD

How to tackle U.S. health reform? Start by being realistic, Baicker suggests. What will fly?

"If I were building a system from scratch, I'd never design a subsidy that only went to people who got insurance through their jobs, and that reserved the highest subsidies for the highest-income people with the most generous coverage. There are also real costs associated with tying insurance to employment, such as making it harder for workers to change jobs if they or a family member falls ill, but it would be dangerous to just throw out the whole system and start over," Baicker warns. About 59 percent of Americans got their health insurance through work in 2007, down from 63 percent five years earlier.

"While the employment-based system inhibits job mobility and threatens the insurance coverage of people who lose their jobs or wish to retire," she observes, "policy makers are justifiably reluctant to dismantle an arrangement on which so many rely and that forms the basis of most 'risk pooling' in insurance markets today."

In talks with employers, hospitals, and patient advocacy groups around the country, Baicker learned that "people are really scared of losing their jobs and health insurance—they dread being thrown into the non-group insurance market." Today, she says, that market is expensive and, particularly in some states, does not offer the long-run financial protection enrollees need.

"Give all Americans with private health insurance the same tax benefit, regardless of where they get their insurance or how generous their policy is." *— Professor of Health Economics Kate Baicker*

One option Baicker likes: Overhaul the current tax subsidy. Instead, she urges, "Give all Americans with private health insurance the same tax benefit, regardless of where they get their insurance or how generous their policy is." Bush's 2007 budget proposed a standard tax-deduction—$7,500 per individual, $15,000 per family. According to estimates by the U.S. Treasury and the Lewin Group, a health care policy research firm, this innovation would reduce the ranks of the uninsured by up to 9 million people, Baicker says. A key feature of McCain's health reform proposal is a flat tax credit for all Americans rather than a flat tax deduction, a more progressive option that accomplishes many of the same goals. McCain's proposed credit would be $5,000 for families and $2,500 for individuals—worth the same amount no matter where people got their insurance, how much it cost, or (unlike a deduction) which tax bracket they were in.

Implications of replacing the current tax exclusion with a flat deduction or credit would differ for the uninsured, for those now purchasing insurance on their own, and for those getting insurance through their employers.

TIME FOR TAX-CODE REFORM? KEY POINTS

THE NEED IS NOW
About 47 million Americans have no health insurance.

THE SYSTEM IS UNFAIR
The federal government has long subsidized health insurance premiums for those who get insurance from an employer. The highest tax subsidies go to people with the highest incomes and the most generous health plan coverage, at the expense of those with lower incomes and less generous—or no—insurance.

AFFORDABLE, BASIC PLANS ARE NEEDED
Replacing the current tax exemption for employer-sponsored insurance with a flat tax deduction or flat tax credit would make insurance more affordable for the uninsured and for those getting insurance on their own in the individual market, and would promote higher-value coverage.

GOVERNMENT SAFEGUARDS AND REGULATORY REFORMS ARE ALSO ESSENTIAL
Tax reforms should be accompanied by regulatory reforms and protections that ensure that people's premiums never go up just because they fall ill, and that low-income earners have the resources they need to be able to afford insurance.

The uninsured would have a new incentive to buy health insurance. According to the Treasury's projections in 2006, for someone in the 15-percent income tax and payroll tax brackets, a $15,000 family deduction would be worth more than $4,500. This is a big share of the average individual-market family policy, which would cost about $5,100, the Treasury estimated. A refundable, flat tax credit would give most of the uninsured an even bigger check to take to the insurance market than a flat deduction would.

People now buying insurance on their own would get a new tax benefit. The insurance that they're already purchasing would now be tax-free.

People receiving insurance through their employer could see their tax bills go up or down. The Treasury estimated that about 80 percent of employees' policies would cost less than the President's proposed standard deduction, which for these workers would result in lower taxes. Since the tax benefit would be flat (under either a flat deduction or a flat credit), workers and companies might choose compensation packages featuring higher wages but lower-premium insurance plans.

EMPHASIS ON VALUE

Rewriting the federal tax code, Baicker says, would help keep insurance affordable. How? By slowing the growth of health care costs.

A flat deduction or credit "creates an enormous incentive to get at least basic coverage, but no added incentive to get a more expensive policy," she explains. Enrollees are likely to choose plans with greater cost-sharing, and spend their dollars on care of most value to them. In the long run, price-sensitive patients will drive greater competition among providers along with cost-saving technological advances.

What's important to stress is not so much lower cost, but higher value, Baicker cautions. Regardless of how much we spend on health care, we must ask: Are the health gains worth our money? In order for people to be able to shop for high-value care, patients and providers must have at their fingertips more and better information by which to judge health care's quality. Just as more research on "best practices" is needed to help caregivers know which treatments work optimally, so too must more data be generated to help consumers select health plans, care providers, and facilities.

TIME FOR CHANGE

Tax reform is merely one component of Baicker's thoughts on health reform. Tax-code reforms would allow millions more Americans to buy health insurance, but what about populations for whom insurance would be out of reach? Millions with very low incomes need help to afford insurance. Those who are sick and uninsured today need help accessing care.

Creative partnerships with state governments will therefore be crucial, Baicker says. In addition, a host of new regulations will be essential to ensuring that insurers cover services fairly and reasonably. "People's premiums should never rise just because they get sick," she asserts.

Many experts disagree with the notion that tax-code reform will lead to wider availability of more basic, and more affordable, health plans. They note that leveling the playing field in this way could hasten the erosion of the employer-based insurance market and leave vulnerable

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populations to fend for themselves in the dysfunctional individual market. Baicker counters that we are already shifting away from employer-based insurance, and that reforming the tax code would give those entering the individual market more resources. She agrees that reform of the individual market should go hand-in-hand with tax-code reform.

NO EASY WAY OUT

Baicker reminds us that "there is no free health care, just as there is no free lunch." Health care will never come cheap, she stresses. "Given that there is a virtually infinite amount of health care that can be delivered, we face tough decisions about how we'll allocate our finite resources." Aspire to high-value care regardless of cost, she repeats.

Given our culture and our partisan political climate, "Reform won't be easy," she says, but "doing nothing is no longer an option." Too many people are uninsured at the same time that "our vast and growing health care expenditures aren't going where they will do the most good."

"There's a fear that changing the current system will force Americans to pay more for their health care," Baicker says. "But they're paying for it already—in ways that could be dramatically improved upon."

Karin Kiewra is editor of the Review *and the associate director of development communications in the Office for Resource Development.*

MORE TO EXPLORE

For more information, see a paper by Baicker published in the July 2007 issue of *Business Economics* and an "Ask the Experts" panel discussion of tax subsidies and health insurance with Baicker that aired on March 20, 2008, at www.kaisernetwork.org.

For other views on the presidential candidates' health reform proposals by Harvard faculty, see an analysis by HSPH health economist Katherine Swartz of Republican nominee John McCain's plan in the September 16 issue of *Health Affairs* (which also ran a critique of Democratic nominee Barack Obama's plan at www.healthaffairs.org). On September 12, HSPH and the *New England Journal of Medicine* co-sponsored a debate on the nominees' plans between Harvard's David Cutler, senior health care advisor to Obama, and his counterpart on McCain's team, Gail Wilensky. To watch it, go to http://www.nejm.org/.