by Gene Steuerle

Congress Spends More to Increase Number of Uninsured

Wait a second, Gene. Didn't you mean to say, "insured" rather than "uninsured," in your title line? What type of editors do you have, anyway? Why would Congress spend more money to increase the number of people who have no health insurance? It's not really that dumb, is it?

Dumb, no. Protecting existing interests, unwilling to truly reform institutions, and favoring symbol over substance, yes. As a result, it *is* going to spend more than $150 billion over the next five years on a provision that increases the number of uninsured. In fact, the headline is tame. Congress is actually planning on spending as much as $1 trillion more within the next quarter century, every year gradually increasing the number of families who go without private insurance.

How so? It's simple. Congress continues to let the cost of a tax subsidy grow without bound. That subsidy is the exclusion from taxation provided for employees (and some self-employed) for the cost of health insurance if purchased through an employer.

Now, wait a second, Gene. How can growth in this exclusion increase the number of uninsured? Doesn't it subsidize the purchase of health insurance? Well, it probably does — on average. But it is at the margin that it distorts behavior the most. The incremental amount spent every year to subsidize higher-cost insurance does little to provide an incentive to purchase insurance in the first place. It is that incremental amount spent on the subsidy that tends to raise costs and increase the number of the uninsured. Here's why.

The exclusion is open-ended. The more insurance we buy, the larger the amount of income we get to exclude from tax and the more the government subsidizes us. The exclusion favors most those of us who have the most generous health insurance policies. Moreover, because more insurance means that we face up even less to the cost of what we buy — we and our doctors now bargain over what the plan, not us, will pay — we demand more care and more expensive care.

The increase in demand is among middle- and higher-income individuals. Low-income individuals will get no income tax break on their health insurance since they owe no income tax, although, if they are workers, they do benefit from a lower Social Security tax.

A portion of that increase in demand doesn't end up buying more health services. Instead it tends to increase pay to providers, ranging from doctors to insurance company employees to workers in health technology. Additionally, the increased demand for health care tends to encourage growth in the health care sector in a less than optimal way. For instance, it tends to encourage suppliers of medical care to increase the quantity of what we get, with less incentive to increase quality. This type of health incentive means more profits for the health company that, say, provides an expensive drug for chronic care for AIDS rather than some less expensive cure.

National income account numbers imply that the health care industry is the only major growth industry in the U.S. economy that is not accompanied by lower-than-normal price growth. Thus, health care can be contrasted with computers, telecommunications and even recreation. As those industries provide more and greater services, their relative prices tend to fall.

As the increased amount of money spent on the exclusion effectively increases the average cost of health care and of health care insurance, the greater the number of individuals in the economy who forego purchasing private health insurance. Not only are low-income people more likely to avoid purchasing health insurance, but many middle-class people and people between jobs decide to take a chance and save the amount of the health insurance premium. Employers, beset by demands from their workers for cash wages, are also more likely to drop health insurance. At times, this happens directly, but more often than not it works its way into the system indirectly. The company with expensive health care insurance reduces the number of its employees, or, if growing, tries to outsource to groups for whom it does not have to pay for insurance. Newer companies without health insurance displace older ones that carry health insurance.

House Ways and Means Committee Chair William M. Thomas, R-Calif., recognizes this problem. At a meeting in February (see *Tax Notes,* Feb. 16, 2004, p. 843) he called the tax incentives for employer coverage "most perverse," tilting more generous coverage to those with the least amount of needs, providing "Cadillac plans" to the haves and little to the have-nots.

But Thomas's ability to reform the way that health insurance coverage is subsidized involves three gigantic hurdles. One is the age-old problem of taking on interest groups who are happy with the status quo. A second is that one has to be willing to accept some complications and some rough justice if one tries to shift money out of the exclusion into some other form of subsidy. But the third and most important hurdle is that Congress and the Executive Branch have little appetite to reform anything when it requires taking any benefit away from anyone. Since 1997, in fact, everything has been a giveaway on the tax or expenditure side of the budget, whether the issue has been tax reduction, Medicare expansion, or anything else.

Perhaps one day Congress will take on the broader issue of entitlement reform, forcing all entitlement programs to go through some of the hurdles required of discretionary programs. Then those programs would be allowed to increase in cost from year to year only after a vote was taken and consideration given to the costs and benefits of any expansion. When that day comes, tax entitlements like the exclusion for employer-provided health insurance should be treated more like any other entitlement on the direct spending side of the budget.

In the interim, the Joint Committee on Taxation and the Congressional Budget Office could make a difference. At a minimum, they could provide annual estimates to Congress of the additional cost of the exclusion. A portion of these costs (the income tax cost but not the Social Security cost) is already implicit in the tax expenditure budget, but the additional spending through these tax subsidies needs to be given more attention. Along with simple cost estimates, these congressional staffs should provide Congress with some very simple estimates of just what it is buying by spending this additional money every year, including the number of people being driven into the ranks of the uninsured.