

Fixing the Nation's Four-Tranche Universal Health System: Next Steps for Both Republicans and Democrats

U.S. citizens soon will be participating in a four-part, nearly universal, health care system. Medicare, Medicaid, employer-provided health, and the new exchange insurance policies all come with different government subsidies. Medicare is tied to age or disability and provides roughly the same amount of insurance to all recipients. Medicaid (and a related children's health insurance program) also provides more or less equal coverage to all who get it, though it pays providers less for that coverage and, cliff-like, often cuts off beneficiaries who cross an earnings line. Subsidies for employer-provided health insurance are largest for those with the highest incomes and the most expensive policies. Meanwhile, the new exchanges created under health care reform would phase out subsidies for households as their income increased.

I find myself in that minority that is uncomfortable with both sides of the current health care debate. I support a more universal health care system but think this four-stream subsidy system is unworkable and unfair. I don't want to go back to having tens of millions of uninsured people, and that could happen if some Republicans fighting health reform prevail by simply restoring the former three-tranche system. But it doesn't help when some Democrats put all their political eggs in the new, still-unworkable exchange subsidy basket.

Both would be taking paths to dead ends—no surprise since neither party is looking hard at the whole crazy quilt system we have created, much less at how the numbers add up, how taxes cover costs, who pays and receives, and how the four subsystems interact.

Of course, you have to start somewhere. How the new exchange policies interact with employer-provided health insurance and, to some extent, Medicaid gets my vote because right now it's where the rubber hits the road. Also, at some level it should appeal to Democratic concerns about extending coverage and Republican concerns about trying to use a market for health insurance.

First, some simple math that's at the heart of health reform. Health spending now averages about 21 percent of households' personal income (17 percent of GDP). Few believe we can afford to pay this much, yet we do. And, the percentage of income spent on health care is rising. We are already financing part of our health care costs by borrowing from China and limiting cash wage growth substantially. Meanwhile, the new health care legislation presumes that those in an exchange shouldn't have to pay more than 10 percent of their income for a health insurance policy. The trouble is, we're already paying a lot more than that to support the three-, soon-to-be four-, tranche system.

This decision to ignore the math has created far-reaching consequences:

- Those in the exchanges will get substantially higher subsidies than will many households that remain in the less subsidized employer-provided insurance market, as well as those on Medicaid.
- To prevent too many employees from getting the new subsidy, employer penalties and other tactics try to keep people within the less subsidized employer network. Even so, droves of employees—potentially tens of millions—are likely to shift out of employer-provided insurance over the next decade or two, especially as newer firms and their employees find it more profitable to get the exchange subsidies than the subsidies for health insurance provided by the employer.
- To try to prevent small employers from bearing the burden of the new system, yet more subsidies and exemptions from employer penalties were created but not distributed fairly according to need.
- To prevent states from shifting from Medicaid, which they help fund, to the exchanges, which they don't, still more restrictions and incentives were designed.
- If, despite all these provisions, these incentives cause too many people to shift to the new, most

generously subsidized tranche (the exchange), the four-stream system becomes even more unsustainable from a budget perspective. After all, every person who receives a higher subsidy will impose additional cost on government

- The exchanges don't just handle health insurance. Rather, they are expected indirectly to operate an entirely new "tax" system that collects another 9 or 10 cents from most insured household for every additional dollar earned and a new "welfare" system that tries to determine in advance and at various later stages households' eligibility for different subsidies.
- It may not be possible for various employers, exchanges, Medicaid systems, and the IRS (which is expected to verify income statements to the exchanges on initial applications, but not later amendments) to share all the data needed to enforce the new subsidies. Think about the logistics of updating the information every time an individual becomes eligible for a higher subsidy because he or she marries, divorces, gains a dependent, moves, changes jobs, and earns less over a stretch of time.

Clearly, to create an administrable system, we need some certainty about the size of the subsidy; to be fair, we need to make the subsidy about the same for all those with equal incomes. This suggests that we must give households throughout the middle-income range (and perhaps those in some Medicaid and higher-income ranges too) about the same level of premium support, while eliminating discrimination against workers with employer-provided insurance. Rather than clawing back the subsidy indirectly with a new, hard-to-administer tax, we must use the current tax system to provide fewer subsidies, on net, to those with higher incomes.

True, health care is now so expensive that it's hard to provide a subsidy high enough to cover most of the cost of insurance. Therefore, we must turn to other alternatives to encourage people to buy insurance. That is one purpose of the new law's so-called mandate—which is not really a mandate at all but a penalty for not buying insurance.

A penalty serves a second and related purpose. It deters people from avoiding insurance purchase when healthy on the expectation that they can buy it cheaply, relative to their costs, when sick. Otherwise, it will not be possible to maintain the popular health reform that prevents insurers from excluding those with preexisting conditions. If current "mandates" are considered unacceptable, a perfectly constitutional and partial fix that both parties could accept might be simply denying other tax and welfare benefits to those who don't buy health insurance.

Concerned about administrative ease and fairness, few Democrats should like subsidizing some families more than others in the same income range or seeing enrollments in employer-sponsored insurance drop. And few Republicans should like the higher subsidies and state cost-shifting that cloud the true tax rates and mandates required to support the system.

The fundamental dilemma for both liberals and conservatives is that we simply can't achieve a more universal health system without charging people for it, enforcing it, admitting to the explicit or implicit tax rates involved, and avoiding very large incentives (for individuals, employers, and state governments) to shift from one tranche of the system to another. Once both sides accept these basic facts and the fundamental arithmetic that drives them, they must turn to the types of amendments suggested here. Neither side is served well by the wishful thinking that pervades the debate over simply maintaining or abandoning the new health care legislation.

The Government We Deserve is a periodic column on public policy by Eugene Steuerle, an Institute fellow and the Richard B. Fisher Chair at the nonpartisan Urban Institute. Steuerle is also a former deputy assistant secretary of the Treasury. The opinions are those of the author and do not necessarily reflect those of the Urban Institute, its trustees, or its sponsors.

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