

When Health Reform Violates Standards of Equal Justice

Many families with moderate earnings pay 20 percent or more of their income for health insurance. By Congressional Budget Office estimates, a family making \$54,000 a year can expect a moderate-cost insurance policy to cost about \$14,700 in 2016. True, employers often contribute a big chunk of the total. But most economists believe that the family really pays by accepting lower cash wages.

Of course, families in this income bracket pay far more than \$14,700 for health care. They get hit by uninsured expenses or covered expenses they have to share—perhaps an average of \$5,100 with the \$14,700 policy just noted. They also pay fairly large amounts of tax to cover others, such as retirees. In fact, Americans spend about 24 percent of monetary income (wages and interest and the like) on health care. Using a more familiar metric, the total comes to 16 percent of the gross domestic product (GDP), though GDP includes many items that aren't typically reported as income (such as the rent you save by owning a home).

Congressional health reformers believe that most households shouldn't pay that much. They propose something closer to tithing. That way, no more than a tenth or an eighth of household income would go to purchase health insurance. This has a nice political ring to it, but here's the reality: the 24 percent burden is rising and can't drop without lower cost growth. Congress can only change who pays or temporarily borrow more from China and other creditors.

The problem gets serious when these arithmetical contradictions get woven into legislation. And we're already on a slippery slope there.

Take the Senate Finance Committee efforts at health reform that have garnered so much attention. Under one version, households with \$54,000 of income would get a subsidy of almost \$10,000 toward the \$14,700 health insurance policy that Congress has decided that they can't afford. The first catch 22 is that since these subsidies are so expensive, Congress plans to exclude from getting the subsidy those households that get health insurance in lieu of higher cash wages from their employer.

This is unfair. It violates the fundamental principle of equal justice. People in similar circumstances should be treated similarly under the law.

It also contorts and distorts the labor market. If this new subsidy were the only incentive or disincentive around, employers would drop health insurance so they could boost cash wages and allow employees to bag the subsidies. But it's not. To prevent this massive migration to the new government-subsidized insurance, Congress also plans to penalize employers who don't provide health insurance and to maintain a fairly inefficient incentive for employer-provided insurance.

The next problem? An employer mandate to pay for employee coverage can work for some employers like a minimum wage increase. Congress doesn't really like that either, so it limits the mandate—for instance, by capping the "tax" on employers who don't provide insurance—in one case, to a maximum of \$400 per employee. The trouble is a small penalty might not stop many employers from dropping health coverage.

Meanwhile, small employers object even to that much tax. So Congress plans to exempt employers with less than 50 employees and provide yet another layer of subsidy to some of them.

Here's yet another complication. Congress is holding fast to today's regressive tax subsidy for employer-provided health insurance, which can be worth \$2,000 to \$6,000 per family. This benefit, an

exclusion from tax of compensation received as health insurance, would be valuable enough to some employers—especially those with highly paid employees who aren't eligible for the new individual subsidies—to keep them from dropping insurance coverage. It is also probably one reason why the Congressional Budget Office estimated that a Senate Finance Committee version of health reform would cause a drop of only about 3 million in employer-provided coverage over the next 10 years. John Shields and Randy Haught of the Lewin Group, in a study for the Peter G. Peterson Foundation, estimated that when fully implemented, this same Senate Finance bill would cause one set of employers to drop insurance coverage for 19 million people but another set to add coverage for 12 million.

Considering the new and old subsidies together gets complicated. Still, many low- and middle-income earners paying through an employer by accepting lower cash wages would lose out big time. They would get thousands of dollars less in subsidy than families making an equivalent amount of total compensation in cash and then getting insurance from the type of insurance exchange that the reform bills would establish.

Here is the bottom line on how employers and employees together can maximize what they get from government. Many employers who don't provide insurance today will probably just choose to pay the tax (\$400-per-employee under one scenario in the Senate Finance bill) for not carrying health insurance. Some small employers might be enticed back into the market by yet another subsidy they would get. Large employers will react by outsourcing more low- to middle-wage jobs and switch more workers from full-time to part-time employment. Such incentives toward a two-tiered labor market, partly segregated by income, aren't new, but they will expand under this type of reform.

A big question for the long run is how small employers who become tomorrow's big employers will behave. In many ways, small and new employers led the movement away from classic pension plans (rather than 401(k) plans) by not offering them in the first place. As these small firms became bigger ones (think information technology and discount retailers), they never retreated to the traditional pension world. Might they do the same with health insurance and never offer an employer plan?

Of course, nothing here is easy to predict—not least because further reform is inevitable given Congress's unwillingness to seriously tackle the unsustainable growth in health care costs.

Still, there are solutions to this problem within a problem within a problem.

The most important step is to accept the standard of equal justice. Move toward a system where everyone with the same income is eligible for the same size subsidy. This means integrating new and old subsidies, rather than forcing millions of workers and employers into shifting jobs and sources of insurance coverage to game a multilayered and distorted system of subsidies.

Done the right way, I believe that Congress could get more equal justice, higher levels of basic insurance coverage for Americans, and lower costs all in the same package.