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CAPPING HEALTH CARE

Having mistakenly agreed with the Clintons' assertion of a crisis in the nation's health care system, the Congress is having a devil of a time in fashioning reforms. The focus of the reform efforts is on health care financing. Relying on the Clintons' premises, would-be Congressional reformers seem to be convinced that, on the one hand, the existing financing system encourages excessive spending on health care and the use of too much of the nation's production resources in providing that care. On the other hand, the near-universal consensus is that far too many Americans do not have health insurance and presumably don't consume enough health care. Moreover, to the extent these uninsured people do consume health care, they do not pay for it themselves but shift its cost to others, in the process driving up the price of health care services.

The real cure is not to be found in premium capping but in shifting the tax deductibility of health insurance premiums from employers to employees and in allowing the self-employed and nonworking individuals to deduct the premiums they would pay for health insurance.

Providing health insurance for those not now insured would surely increase the aggregate amount of spending and resource commitment for health care; to avert this undesirable development, something must be done, so it would appear, to make sure that everyone consumes less health care. Wittingly or not, health care finance reformers seem to be intent on a particularly pernicious form of wealth redistribution requiring the vast majority of Americans to receive substantially less health care in order to provide somewhat more of it to a relatively small group.

Instead of identifying and rectifying the government policies and programs that impede efficient functioning of the health care market, Congressional policy makers have been concentrating on dreaming up new government interventions. Capturing the attention of legislators currently is the notion that capping the amount of premiums paid for health insurance is an essential element in any effective health care reform measure. At the extreme is the Clintons' plan that would, by fiat, set the per capita health insurance premium targets in each regional alliance. Variations in other reform plans to achieve this same goal would cap the tax benefits under the current tax treatment of employer-provided health insurance; either the employer's deduction of health insurance premiums would be subject to some limit or the insured employees would be required to include some or all of the employer-paid premiums in their taxable incomes.

A number of *seemingly* reasonable objectives are sought by capping health insurance premiums. Premium caps would require either cutting back on the health care services for which insurance benefits would be provided or, by hiking the insurance policies' deductibles and co-payments, increasing the amount of out-of-pocket payments by the insured person. In either case, the proposed limits on the premiums that might be paid or deducted for tax purposes would lead to lower total outlays for health care. This, presumably, would offset the additional costs resulting from extending coverage to those now uninsured.

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Proponents of capping see increases in federal tax revenues and reduced federal budget outlays as collateral benefits of capping health insurance premiums. Capping employer-paid premiums or their deductibility necessarily results in increasing the employing business's taxable income, hence its income tax liability. Requiring the employee to include in his or her income the premium deducted by the employer would also be a revenue gainer, presumably a significantly more productive one than merely capping the employer's deduction or the permissible premium payment.

Capping premiums or their deductibility would increase employers' costs for providing executives and upper-echelon employees more generous health insurance policies than are provided for rank and file employees. The premiums attributable to the extra benefits for the higher paid employees presumably would exceed the caps and would, therefore, have to be paid out of the business's after-tax income. The additional cost of such benefits would exert pressures to curtail them. Members of Congress who stress tax "fairness" or income redistribution as an important public policy goal see this result as a significant advantage of imposing limits on premiums or their deductibility.

The trouble is that capping health insurance premiums or their deductibility is, at best, a bandaid approach to dealing with the problems created by employer-provided health insurance and third-party payment of medical bills. The core problem is that the current methods of financing health care mask the real costs of that care from its consumers who, therefore, do not economize on its consumption. The primary effects of capping would be to (1) reduce the amount and range of health care benefits that would be covered by employer-provided plans and (2) as a consequence, limit the total consumption of health care. Capping would not more clearly reveal the true cost of health care and thereby encourage consumers to economize in their purchases of it. On the other hand, if people were aware of the true costs they incur for health care, there would no occasion for public policy to address the total amount of health care that is consumed, whether that amount would be greater, less, or the same as under the present modes of health care finance.

The real cure is not to be found in premium capping but in shifting the tax deductibility of health insurance premiums from employers to employees and in allowing the self-employed and nonworking individuals to deduct the premiums they would pay for health insurance.

This would in turn result in major changes in the health insurance market. The most obvious change would be that few employers would continue to include health insurance in their employees' compensation packages, substituting cash wages and salaries or other kinds of tax-deductible payments for the health insurance benefits for which they would no longer be responsible. In terms of tax considerations, the employer would be indifferent between paying employees in cash or providing them health insurance coverage of equal cost. The change would, however, free the employer of the onerous task of negotiating offsetting adjustments in other elements of compensation when health insurance premiums rose more than the work force's productivity.

This shift in the locus of the tax treatment of health insurance would lead to a much freer and more efficient health insurance market. In most employer-provided health insurance plans, benefits, deductibles, and co-payments are standardized, reflecting the average makeup of the work force in terms of relevant health attributes. Such practices amount to a kind of community rating under which the young and healthy members of the work force pay higher premiums for given health coverage, and thereby forgo more cash wages, salaries, and other compensation, than would be necessary if they were not grouped with older workers, while older workers, by the same token, pay less. In effect, the younger workers are overcharged to subsidize the health care of older workers with

more health problems. Shifting the responsibility for the purchase of health insurance and the associated tax benefits to the individual would give people the opportunity to seek the kind of coverage they deemed to be best for their situation and needs and would reduce, if not totally eliminate, this concealed subsidization.

By the same token, it would lead to much greater diversity in the kinds of health insurance policies that insurance companies would offer. There would be no loss of coverage when changing jobs; portability of coverage would be automatic. With individual responsibility and tax deductibility, the emergence of a demand for extended period health insurance — insurance that is renewable for a number of years at a fixed premium — would in all likelihood induce insurance providers to offer such policies at appropriate premiums. This feature is virtually unknown in large, employer-provided health insurance policies; it would be prohibitively expensive for any work force with a significant number of older employees, those for whom the feature would be most attractive. Since premiums vary inversely with deductibles and co-payments, many individuals would be inclined to purchase policies with large deductibles and, possibly, large co-payments; a significant market for catastrophic care policies would develop, replacing the prevalent low deductible, low co-payment policies. If insurers' premiums were not limited by regulatory authorities or statutes, policies providing coverage for treatment for existing conditions would also be available, at premiums reflecting the risk involved. In all, a much greater variety of insurance products, more closely suited to differing demands, would be offered and purchased.

These changes in the health insurance market would, to be sure, entail some costs, primarily the loss of some of the information and transaction economies afforded by employers' providing large group coverage. On the other hand, insurance companies would offer group policies based on relevant risk factors, thereby affording at least some part of those economies.

Shifting deductibility of health insurance premiums from employers to individuals is certainly not a solution to all of the problems presented by the current health care financing system. It is, however, a major first step and a far better approach than capping employers' premium deductions or eliminating the exclusion of health insurance premiums from covered employees' taxable incomes. Moreover, it is a solution much more in keeping with the requirements of a free market in health care financing than virtually any of the grand "reform" schemes now occupying policy makers' attention. Free market ideology and political exigency may appear to be at odds, but for effective solutions of the health care financing problems with which it is now occupied, Congress would be well advised to try a little free-market medicine.

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