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The Tax Treatment of Health Care

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Oral and Written Statement

Chairman Brady, Ranking Member Levin, and members of the Ways and Means Committee: thanks for inviting me to speak with you today about the tax treatment of health care.

My name is Avik Roy, and I'm a Senior Fellow at the Manhattan Institute for Policy Research, in which capacity I conduct research on health care and entitlement reform.

In my remarks today, I'll focus on three areas. First, I'll discuss how the present tax treatment of health care is the central flaw in our health care system. Second, I'll address arguments made by opponents of health tax reform. Third, I'll discuss the principles of sound health tax reform.

Health tax policy: The central flaw in our health care system

It goes without saying that Republicans and Democrats, often don't see eye to eye on health reform. But we all agree that it is extremely important to improve the affordability of American health care.

The high and rising price of U.S. health care is the principal reason that tens of millions of Americans are uninsured. And it's the biggest driver of growth in government spending, and thereby of our debt and deficit.

According to survey data compiled by the Congressional Budget Office, among adults who have been uninsured for longer than 12 months, 98 percent cited the high cost of health insurance. 83 percent cited a lack of access to employer-sponsored insurance. Only 6 percent cited poor health status—such as a pre-existing condition—as a barrier to health coverage.

The high cost of health care also has a profound impact on those who manage to maintain coverage. The fact that the median worker's paycheck has barely increased in three decades is a widely discussed problem. But overall compensation to the American worker has grown. The problem is that most of the growth in compensation has been eaten up by the rising cost of health insurance. In 1996, the cost of health insurance to an individual was 11 percent of per-capita income. In 2010, it was 19 percent. In short, health care inflation is the biggest driver of wage stagnation.

And the CBO's long-term budget outlook indicates that nearly the entirety of the growth in federal spending over the next several decades is driven by two factors: growth in health care spending, and interest on the federal debt. Growth in health spending, in turn, is driven by two factors: the aging of our population, and the rising cost of delivering health care.

Some of these problems are driven by the fact that beginning in World War II, the federal government encouraged employers to replace take-home pay with health care spending, because employer-sponsored health coverage was excluded from the tax code.

Hospitals, doctors, drug companies, and other participants in the health care industry have a powerful incentive to charge high prices in the U.S., because the employer tax exclusion prevents patients from controlling their own health care dollars—and thereby holding health care companies accountable for the prices they charge.

Responding to opponents of health tax reform

Today, the value of the employer tax exclusion—in terms of federal, state, and local income taxes, and federal payroll taxes—exceeds 500 billion dollars a year. That is a greater sum than what federal, state, and local governments spend on Medicaid each year. 154 million Americans gain health coverage through their employers. So it is extremely important to handle reform of the employer tax exclusion with great care.

But that is different from opposing reform altogether. For the reasons I've described, mitigating the tax code's impact on health care inflation must remain a central objective of health reform.

Republican-aligned opponents of health tax reform argue that the employer-based health insurance system is a bulwark against single-payer health care, or another type of government-run system. But that is manifestly untrue. The rising cost of coverage since World War II—primarily driven by the employer tax exclusion—has been the principal argument for every major expansion of government-run health care since then.

Switzerland, by contrast, has a health care system in which every Swiss citizen purchases private health insurance on a regulated market. That system is not perfect, but it has been a robust bulwark against single-payer health care. In 2014, the Swiss rejected a referendum to replace their market-based system with single-payer health care, by a margin of 62 to 38 percent. People like choosing their own health coverage, and will never allow the government to take away that right if they have it.

Democrat-aligned opponents of health tax reform argue that health tax reform would increase costs for workers, especially members of public-sector unions. But the opposite is true: health tax reform, done properly, would put more dollars in the pockets of workers, rather than insurance companies.

Principles of health tax reform

There are two core principles to high-quality health tax reform. The first is that reform should give workers more choice to purchase the kind of health coverage that is affordable for them and their families. The second is that reform should be enacted gradually, so as to give insurers and providers the time needed to bend the cost curve downward.

The so-called “Cadillac Tax” in the Affordable Care Act resembles such reform by taxing high-value employer health benefits. But that tax contains many exceptions and loopholes, and does not deploy the revenue it raises to aid all those who would like to purchase insurance on their own.

The best way to expand health insurance choices for workers is to truly equalize the tax treatment of employer-purchased and individually-purchased coverage, through a cap on the employer tax exclusion that is gradually phased in over time. Congress could design a cap that raised an equivalent amount of revenue as the Cadillac Tax, while considering the additional goal of providing tax relief to every American who purchases health coverage on their own.

Finally, in my limited time, I should address an important aspect of health tax reform: offering premium assistance through refundable tax credits to those with no income tax liabilities. There is wide bipartisan agreement on the importance of such tax credits in expanding coverage to the uninsured.

The ACA deploys tax credits for this purpose, which is laudable. The biggest problem with the ACA is that it burdens the individual insurance market with costly mandates and regulations that make health coverage unaffordable for millions of people that the law was designed to help.

Some scholars endorse a system of uniform tax credits, similar to the one proposed by Senator McCain in 2008, in which every American would get an identical credit with which to purchase the health coverage of his choosing. But such a system would necessarily undersubsidize the poor, the sick, and the vulnerable, while oversubsidizing the wealthy.

Tax reform for the uninsured should embrace the best of both of these concepts. It should be means-tested, so that those who are most in need of assistance can afford health coverage. But refundable tax credits should maximize the opportunity for individuals to choose the health care and coverage that is best for them—including the utilization of health savings accounts—instead of requiring Americans to buy a one-size-fits-all form of coverage designed for them by the federal government.

In this way, we can achieve the goals that every member of this committee shares: ensuring that every American has access to quality, affordable health care. We all know how challenging health reform is to achieve. But we also know how important it is to the future of our country.

Thanks again for having me. I look forward to your questions, and to being of further assistance to this committee.