

# Health Care

America's health care system is in dire need of reform. Health care is a huge and growing sector of the economy. In 2008, Americans spent roughly \$2.4 trillion on health care, which is roughly one-sixth of the nation's economy—and the government is responsible for approximately 50 cents out of every dollar spent. The large and growing role of government in the financing of health care has led the health sector to become one of the most heavily regulated parts of the American economy. More government financing has increasingly meant more government control, and more government control means less personal freedom for individuals—both as patients and as consumers of health care.

To protect personal freedom in health care, changes at the federal and state level are needed in order to enable individuals and families to own and control their own health insurance policies and to take them from job to job without tax or regulatory penalties. Currently, very few Americans know the cost of their health coverage or the care they receive. Only 9 percent of Americans directly purchase their own health insurance, and prices of health care goods and services are rarely transparent. Individuals and families should have the right to buy the health insurance plans they want and obtain care at a price they are willing to pay. To deliver better value to patients at lower costs, health plans and providers should have to compete on a level playing field in a free and open market where government will not be in the business of picking winners and losers. For health care reform to be meaningful, it must give patients more direct control over their own health care decisions and dollars.

Medicare, the federal program which provides health care for individuals age 65 and over and for those with certain disabilities, has grown dramatically since its enactment. In 1970, an estimated 20.4 million individuals were enrolled in Medicare. By 2008, the number of enrollees had more than doubled. While some in Washington say that Medicare reform should wait until Congress somehow fixes the broader health care system, the truth is that Medicare itself is a major driver of health care costs. Medicare has an unfunded obligation of almost \$38 trillion, and within three years the first wave of the gigantic baby boom generation will start to retire and impose a demand on medical services unprecedented in the nation's history. The traditional Medicare program is not capable of absorbing such a shock without some fundamental changes. Medicare

## Notes

should remain as it is today for current beneficiaries. But at a date certain, Medicare should be transformed into a defined-contribution system in which the government contribution for benefits is adjusted for age, income, or health status. The elements of reform have been discussed for many years and have been advanced by responsible analysts and public officials, including the 1999 National Bipartisan Commission on the Future of Medicare.

Medicaid and the State Children's Health Insurance Program are joint federal-state health care programs serving a diverse population of the poor, including children, adults, the elderly, and the disabled. In 1990, 22.9 million people were enrolled in Medicaid, a figure which has more than doubled since. Over the years, states have used their authority to expand Medicaid, making it the largest budget item for most states. Medicaid gets 43 percent of funding (on average) from state and local governments and according to the National Association of State Budget Officers, "[t]he states are facing one of the worst fiscal periods in decades." Recognizing this situation in 2009, Congress provided states with a temporary increase in the federal match for Medicaid worth \$87 billion through the American Recovery and Reinvestment Act of 2009. Federal proposals to further expand Medicaid as part of a health care reform effort are misguided and wrong-headed. Instead of expanding government-run programs like Medicaid, federal policymakers should offer tax relief or vouchers to individuals who purchase private health insurance. Congress could achieve more coverage and save money by transitioning those already on Medicaid into private insurance. Short of Congress acting in this way, the states can and should use their existing authority to reform their public programs.

## RECOMMENDATIONS

**1. Reform the tax treatment of health insurance.** The current tax treatment of health insurance is a byproduct of wage and price controls imposed by the Roosevelt Administration during the World War II era. The federal tax code currently excludes, without limit, the value of employer-sponsored health insurance from an individual's income for the purposes of both income and payroll taxes. This tax exclusion for employer-sponsored insurance is a huge, but hidden, tax subsidy to the tune of more than \$200 billion a year. Only individuals with employer-sponsored insurance are able to receive tax relief, while individuals without access to such coverage typically pay for health insurance with after-tax dollars and, in effect, face a sizeable tax penalty. Aside from its sheer size—and the unfairness inherent in the fact that it offers tax relief only to those with employer-based coverage—if the tax exclusion's goal is covering the uninsured, then it is poorly targeted. While the exclusion does encourage individuals to buy coverage, it also provides the largest tax subsidies to those who need them least and little or nothing to millions of middle-income families who need help buying health insurance. The exclusion creates a bias toward overly

generous insurance—even first-dollar coverage—with low cost-sharing in the form of co-payments, coinsurance, and deductibles because out-of-pocket expenditures, for the most part, do not enjoy a similar tax preference. This incentive reduces the price sensitivity of health care consumers and leads to higher prices and greater utilization. For years health economists have argued that the tax-free status of employer-sponsored health insurance should be capped or possibly even eliminated completely and replaced with greater tax relief for individuals and families with lower-incomes and new tax relief for those who obtain health insurance outside the place of work. To achieve this, economists have suggested either a tax deduction or tax credits, or both.

**2. Reform insurance markets at the state level.** The beauty of federalism is that it enables states to determine locally the best ways to achieve objectives we share as a nation, as well as to innovate, thereby appropriately limiting the role of the central government and fostering creative diversity. In terms of health care reform, the solution is for Washington to only identify the broad goals of a health system and to encourage states to devise the best ways to achieve those goals. It is important to then marry those national goals with a procedure to enable states to try innovative approaches to reach them. That can be done in a bold way by making it possible for states to obtain congressional approval for significant changes in existing laws and programs—i.e., by granting the states waivers from federal laws, not just from regulations—so that they can restructure public programs and reform their health insurance markets in creative ways of expanding affordable coverage. States can and must design approaches to meet broad goals of accessibility (including underwriting and issuance rules to achieve continuous coverage), adequacy (benefit categories), affordability (perhaps through establishing a benchmark plan), and portability (including an exchange or similar risk-pooling mechanism). To achieve portability across state lines, states might draw up agreements or compacts with other states. Alternatively, Congress could consider adopting legislation to facilitate interstate commerce in such a way that does not preempt, undermine, or override innovative state health care reforms. This bipartisan concept of creative federalism is intended to encourage reasonable ideas from across the spectrum to be tried and compared in order to find the best answers to the challenges posed by rising health care costs and the growing number of uninsured Americans.

**3. Reform Medicare, Medicaid, and the State Children’s Health Insurance Program.** Public health programs, particularly Medicare, Medicaid, and the State Children’s Health Insurance Program have fueled the growing role of government in health care. Independent analysts, as well as the Government Accountability Office (GAO), the watchdog of Congress, have repeatedly warned Congress and state officials that their budgets and taxpayers are already on a collision course with the rapidly rising costs of entitlement programs.

## FACTS AND FIGURES

## Notes

- In 2008, Americans spent roughly \$2.4 trillion on health care, which is roughly one-sixth of the nation's economy—and the government is responsible for approximately 50 cents out of every dollar spent.
- The tax exclusion for employer-sponsored insurance is a huge, but hidden, tax subsidy to the tune of more than \$200 billion a year.
- In 1970, an estimated 20.4 million individuals were enrolled in Medicare. By 2008, the number of enrollees had more than doubled.
- Medicare has an unfunded obligation of almost \$38 trillion because of benefits that have been promised but not paid for.
- In 1990, 22.9 million people were enrolled in Medicaid, a figure which has more than doubled since.

## ADDITIONAL RESOURCES

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Nina Owcharenko, "A Principled Path to Rational Health Care Reform," Heritage Foundation *WebMemo* No. 2448, May 15, 2009, at <http://www.heritage.org/Research/HealthCare/wm2448.cfm>

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Greg D'Angelo and Robert E. Moffit, "Time to Get Serious (Again) About Medicare Reform," Heritage Foundation *WebMemo* No. 2441, May 13, 2009, at <http://www.heritage.org/Research/HealthCare/wm2441.cfm>

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