ACCESS FINANCING ORGANIZATION DELIVERY OUTCOMES

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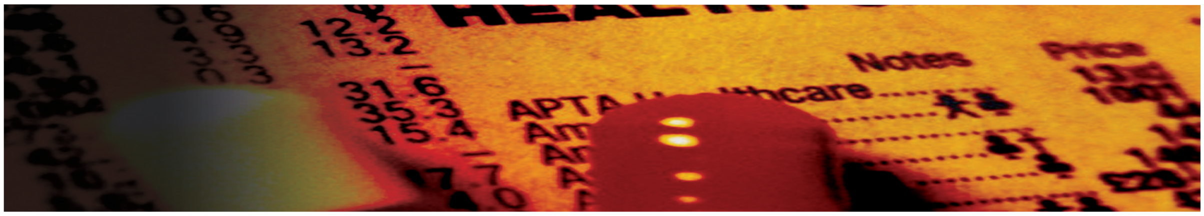
Issue 3



HEALTH POLICY research

James A. Baker III Institute for Public Policy-Baylor College of Medicine
Joint Program in Health Policy Research

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IN THIS ISSUE

In the June 2010 issue of the *National Tax Journal*, Vivian Ho, Ph.D., reviewed the book "Using Taxes to Reform Health Insurance," which was edited by Henry J. Aaron and Leonard E. Burman and published by the Brookings Institution Press in 2008. Ho is the James A. Baker III Institute Chair in Health Economics, as well as a professor at Rice University and an associate professor at Baylor College of Medicine in Houston, Texas.

Does the tax treatment of health insurance contribute to rising health care costs in the United States?

Yes, says Vivian Ho, a health care economist who was invited by the *National Tax Journal* to review the Brookings Institution book, "Using Taxes to Reform Health Insurance." "Health care and health insurance continue to become increasingly unaffordable in this country due to sustained increases in health care costs that have exceeded the overall rate of inflation year after year," says Ho. She believes that if health care cost growth can be slowed, health insurance premiums will become more affordable, and Medicare and Medicaid will not be as significant a strain on government budgets. Ho notes that the Brookings analyses correctly make the case that generous subsidies provided to higher-income earners in the tax treatment of employer-sponsored insurance (ESI) lead to overconsumption of health insurance and health care, which is fueling cost growth.

Since the 1940s, health insurance provided by employers has not been treated as taxable income for workers by the Internal Revenue Service. The tables and figures in the Brookings volume illustrate the magnitude of ESI, and its relatively large subsidy for high-income filers versus low-income households. The combined value of income and payroll tax exclusions can reduce the overall cost of health insurance by 25 percent or more for middle-income families. The amount of the subsidy is greatest for the highest income earners purchasing health insurance, because they face the highest marginal tax rates. The 0.5 percent of taxpayers in the highest 35 percent tax bracket pay only 62.6 percent of the full price of health insurance due to the tax exclusion. Data from other studies demonstrate that excluding employer-purchased health insurance premiums from income tax leads employees to purchase more health insurance than they would otherwise, which leads to overconsumption of health care services as well.

Unfortunately, the federal health reform legislation does little to address this issue. The Patient Protection and Affordable Care Act of 2010 will begin taxing employer-sponsored health plans on values that exceed $10,200 for individuals and $27,500 for families in 2018. However, the average health insurance premium for ESI plans was only $4,824 for individuals and $13,375 for families in 2009. Thus, very few employees will be subject to these new taxes when they become effective. "Greater taxation of health insurance policies alone would not stop rising health care costs in their tracks," concludes Ho. "But the Brookings analyses indicate that gradually eliminating the tax exclusion for employer-provided insurance would significantly reduce the growth of health expenditures in the U.S."

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The Baker Institute and the Baylor College of Medicine's Section of Health Services Research work with scholars from across Rice University and the Baylor College of Medicine to address issues of health care — access, financing, organization, delivery and outcomes. Special emphasis is given to issues of health care quality and cost.

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