



Breaking the Tie That Binds Health Care and Employment

by Brad Cook

Federal tax expenditures for health benefits include employer health benefit contributions for workers and retirees, health benefit deductions for the self-employed, health spending under flexible spending plans, and the tax deduction for health expenses. Tax expenditures for health benefits were estimated to cost the federal government \$188.5 billion in lost revenue in 2004¹ and were driven by the exemption of employer provided health benefits. The deductions for the self-employed and out-of-pocket health spending accounted for less than five percent of lost revenue.

The current tax exemption for employer provided health care was developed shortly after World War II when wage and price controls were in effect. The controls are gone, but the exemption remains. The employer sponsored model made sense when there was only one bread earner in a family, who usually stayed at one job his entire life. However, it needs to be updated to adapt to a twenty-first century workforce, where many families have multiple bread earners, employees are less likely to stay at one job their entire lives, and workers are more likely to take an extended leave of absence from the workforce.

One problem with the employer-provided health-insurance tax exemption is that it is becoming increasingly more regressive. The average health-benefit tax expenditure was about \$1,482 per family in 2004. However the average-income worker receives less of a benefit than higher-income workers. The tax expenditure for the average family with an income level between \$30,000 and \$39,999 was \$1,231, whereas the tax expenditure for families earning over \$100,000 was \$2,780.² The disparity between average-income and high-income earners is increasing. For example, in 1998 families earning over \$100,000 accounted for 23.6 percent³ of the tax expenditure, and this increased to 26.5 percent in 2004. And, even though families with an income below \$50,000 represent 57.5 percent of all U.S. families, they account for only 26.7 percent of the tax expenditure.⁴

Not only is the employer-provided tax exemption regressive, but it is also undermining entrepreneurship and small business. The Kaiser Family Foundation estimated that “there are at least five million fewer jobs providing health insurance in 2004 than in 2001. A likely contributing factor is a decline in the percentage of all small firms (3-199 workers) offering health insurance.” While 99 percent of large firms (200+ workers) continued to offer health insurance, the number of small firms offering health insurance decreased from 68 percent in 2001, to 63 percent in 2004. Overall, the percentage of workers receiving health coverage from their employer declined significantly between 2001 and 2004, from 65 percent to 61 percent.⁵ Large firms have a distinct advantage over small firms because they can create a larger pool of employees to keep the average cost of providing health coverage down, and therefore they are more likely to offer their employees health insurance. Small businesses are hurt by the tax expenditure because the owner of a small business will have a difficult time attracting and maintaining employees if they cannot afford to provide health insurance.

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Public Interest Institute at Iowa Wesleyan College

600 North Jackson Street

Mt. Pleasant, Iowa 52641-1328

Phone: 319-385-3462 Fax: 319-385-3799

E-Mail: public.interest.institute@limitedgovernment.org Website: www.limitedgovernment.org

In addition, employer-provided health care is not portable. If an employee leaves a job, he or she also loses health coverage. A recent study estimated that about half of all bankruptcies in America are medical bankruptcies, affecting 1.9 to 2.2 million Americans in 2001. Of the medical bankruptcy filers, 75.7 percent had insurance at the onset of illness, but because major illness often leads to job loss, many subsequently lost their health care coverage.⁶ Job loss, for any reason, leaves families without coverage when they are financially most vulnerable.

For those that do not receive employer provided health coverage, it becomes more expensive to purchase, because they must use after-tax dollars. Assuming a marginal tax rate of 40 percent, a family that earns a combined income of at least \$45,000 a year and does not receive employer-provider health insurance, must earn \$1.67 to buy \$1 of health insurance.⁷

Lawmakers need to reform the tax treatment of health-care expenses to reduce the burden placed on those who do not receive employer-provided health care and must make it easier for working families to choose their own form of health care. The tax code should be reformed to promote consumer-driven competition in health care, by adopting refundable tax credits for health insurance. Such tax credits would eliminate the increasingly regressive benefits for higher income employees that make health care more expensive for those who do not have coverage. Tax credits would also allow Americans to choose health plans that best fit their needs.

The tax code should also encourage alternative insurance pools that can group many people together, which spreads the insurance risk and lowers the average health-care costs per individual. The alternative insurance pools can include unions, large church organizations, and farm bureaus, not just small businesses. These pools should also not be confined to state boundaries.

The current tax code, tying health coverage to employment, is outdated and leaves many hard-working Americans uninsured. Of the 44.7 million non-elderly uninsured Americans in 2003, over two-thirds came from families with at least one full-time worker.⁸ By adopting tax credits and allowing for alternative insurance pools, many of these hard working Americans will be able to choose and purchase their own health coverage that best meets their needs.

(Endnotes)

¹ John Sheils and Randall Haught, "The Cost of Tax-Exempt Health Benefits in 2004," *Health Affairs*, February 25, 2005, <<http://content.healthaffairs.org/cgi/reprint/hlthaff.w4.106v1>> (March 1, 2005).

² Ibid.

³ John Sheils and Paul Hogan, "The Cost of Tax-Exempt Health Benefits in 1998," *Health Affairs*, Volume 18, Number 2, March/April 1999, <<http://content.healthaffairs.org/cgi/reprint/18/2/176>> (March 1, 2005).

⁴ John Sheils and Randall Haught.

⁵ The Kaiser Family Foundation and Health Research And Education Trust, "Employer Provided Health Benefits: 2004 Summary of Findings," <<http://www.kff.org/insurance/7148/index.cfm>> (March 1, 2005).

⁶ David U. Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, "Illness And Injury As Contributors To Bankruptcy," *Health Affairs*, February 2, 2005, <<http://content.healthaffairs.org/cgi/reprint/hlthaff.w5.63v1.pdf>> (March 1, 2005).

⁷ Sally C. Pipes, "Miracle Cure: How to Solve America's Health Care Crisis and Why Canada Isn't the Answer," Pacific Research Institute and The Fraser Institute, 2004, p. 28.

⁸ Kaiser Commission on Medicaid and the Uninsured, "Health Insurance Coverage in America: 2003 Data Update," Kaiser Family Foundation, November 2004, p. 14, <<http://www.kff.org/uninsured/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=49550>> (March 6, 2005).

Brad Cook is a Research Analyst with Public Interest Institute.

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