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RESEARCH SUMMARY

Reforming Government Subsidies to Private Health Insurance: How to Tackle Distortionary Effects and Increase Aggregate Utility

Health benefits received from an employer are not currently treated as taxable income by the US government. As a result, Americans with employment-based insurance enjoy coverage that is more generous (e.g., through lower deductibles and copayments) than it would otherwise be. This, in turn, leads to higher overall healthcare spending as people overconsume low-value medical care owing to overly generous health plans.

Changing how the government subsidizes private health insurance could induce employers to switch to health plans that better satisfy the needs of their employees. Bradley Herring and Erin Trish examine the impact of such a change in "Quantifying Overinsurance Tied to the Tax Exclusion for Employment-Based Health Insurance and Its Variation by Health Status."

THE CURRENT TAX EXCLUSION FAVORS OLDER, SICKER PEOPLE

If individuals do not bear the full cost of their healthcare expenses, they are likely to spend more on healthcare than they otherwise would.

- Older people with chronic health conditions have benefited from the employment-based tax exclusion. It has allowed them to benefit from plans that are more generous than would otherwise have been the case.
- Younger people without chronic health conditions have been made worse off by the tax exclusion. The exclusion has given employers an incentive to provide more generous coverage than this group would have desired.

EFFECTS AND TRADEOFFS OF LIMITING THE TAX EXCLUSION

Reforms to limit the tax exclusion for employment-based insurance could increase aggregate expected utility—overall levels of satisfaction with medical care and the insurance coverage that finances it. However, while the welfare of some segments of the population could increase, the welfare of others could decrease.

- Reforms could be coupled with a mechanism to convert the government's newfound tax revenue (through increases in taxable income) into budget-neutral reductions in tax rates without having larger subsidies for more generous healthcare plans.
- Changing the way that the federal government subsidizes private health insurance in such a budget-neutral way could induce employers to switch to a health plan that, on average, better satisfies the needs of their employees for lower costs. The gains in welfare from this policy change would disproportionately benefit younger people without chronic health conditions. Older, less healthy workers would be worse off.

- Providing alternative tax subsidies and better enabling choice across multiple types of plans could, in principle, result in improvements in expected utility for some while making no one worse off. Younger, healthier people would be able to switch to less generous plans while older, sicker people would be able to remain in more generous plans better suited to their underlying preferences.