JOINT ECONOMIC COMMITTEE

Senator Sam Brownback, Ranking Republican

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All the Wrong Incentives: How Democrats' Health Care Reform Proposals Would Harm Workers and Families

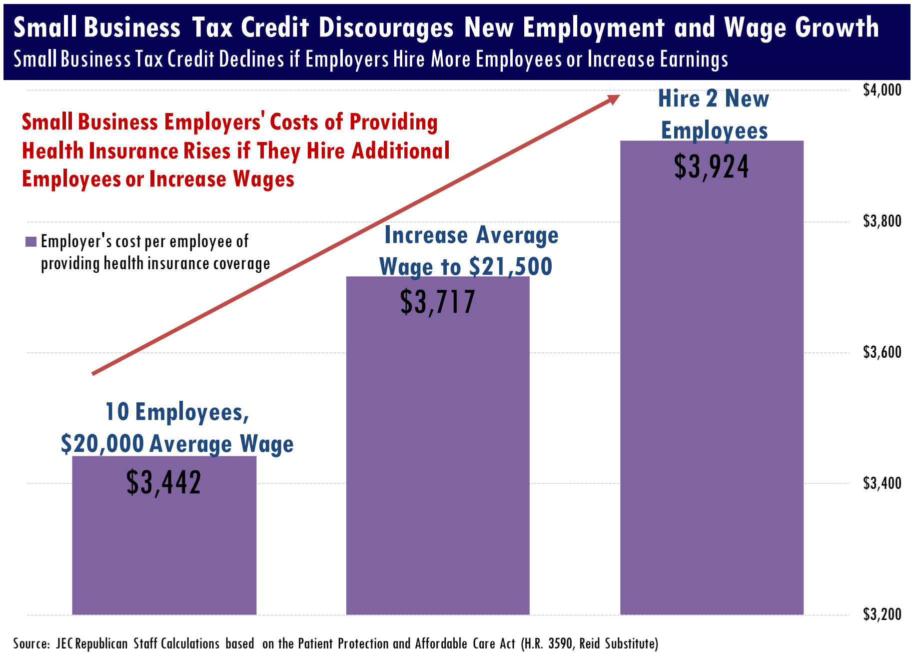
3 *Third in a series*

House and Senate Democrats have proposed legislation to extend health coverage to an estimated 94% of authorized U.S. residents at a cost to taxpayers of $2.5 trillion over the first ten years of full implementation. [1] *While covering only half the uninsured, these bills would set the U.S. on the path to a single-payer, government-run health insurance system of the sort found in Europe and Canada. In so doing, the proposals would reduce the control of individuals over their health care choices, and would limit the ability of doctors and hospitals to care for patients with the kind of personalized treatments that best suits patients' unique situations. Even more troubling, these proposals would create a series of perverse incentives ultimately harmful to workers, businesses, and the entire economy. For example, the bills contain strong disincentives for small employers to hire more employees or raise wages.*

CASE # 3: DISINCENTIVES FOR JOB CREATION AND HIGHER WAGES

Small Business Subsidies Discourage Job Creation and Wage Growth

Both the House and Senate bills include temporary subsidies to small businesses to encourage them to offer employer-sponsored health insurance. The credits are available to businesses with 10-25 employees and average employee salaries of $20,000-$40,000. The maximum credit—equal to 50% of the business's costs of providing health insurance—is available to businesses with 10 employees and an average salary of $20,000. As the number of employees increases, or as salaries increase, the amount of the credit provided to the business decreases.



[1] CBO estimates that 83% of authorized U.S. residents are currently insured.

Consider the example of a business with 10 employees and an average salary of $20,000. If half the employees take single coverage and half take family coverage, the average premium for the employees would cost $9,100.[2] Of this amount, the business would pay an average of $6,884 and the employee would pay an average of $2,216.[3] The business's total health care costs would be $68,838, for which the business would receive a 50% tax credit worth $34,419. The credit would bring the average cost per employee of providing health insurance to $3,442.

If the business were to hire two additional workers, its tax credit would be reduced to 43%, and its average after-tax cost of health insurance per employee would rise by $482, from $3,442 to $3,924, for a total increase in health insurance costs of $12,666. This means that hiring two new workers does not cost only $40,000 in wages, but rather $52,666 in total compensation costs.

The small business subsidy not only discourages employers from hiring new employees, but it also discourages them from increasing employees' salaries. If a business with 10 employees and an average salary of $20,000 were to increase the average salary by $1,500, its tax credit would be reduced to 46%, resulting in a $275 increase in the business' per employee health insurance cost and a total health insurance cost increase of $2,754. In this case, increasing employees' salaries by a total of $15,000 actually costs the employer $17,754.

Although the tax credit applies to a small number of businesses and is only temporary, it discourages employers from creating new jobs and from increasing employees' salaries. The temporary status of the subsidies makes providing health insurance for the long-term uncertain if not altogether unlikely. Because small businesses receiving the credits would have an incentive to drop health insurance coverage once the credit expires, there would likely be political pressure to retain the tax credit at a substantial cost to taxpayers. Retaining the tax credit would reduce costs for some small businesses, but would also maintain the perverse incentive for small businesses to employ as few workers as possible and to hold down their wages.

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[2] According to the Kaiser Family Foundation, the average individual health insurance premium in 2009 cost $4,824 and the average family premium cost $13,375. http://ehbs.kff.org/pdf/2009/7936.pdf

[3] According to the Kaiser Family Foundation, the average employee contribution for an individual health insurance premium in 2009 was 17% and the average employee contribution for a family plan was 27%. http://ehbs.kff.org/pdf/2009/7936.pdf