Joint Economic Committee

Senator Sam Brownback, Ranking Republican

December 15, 2009

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

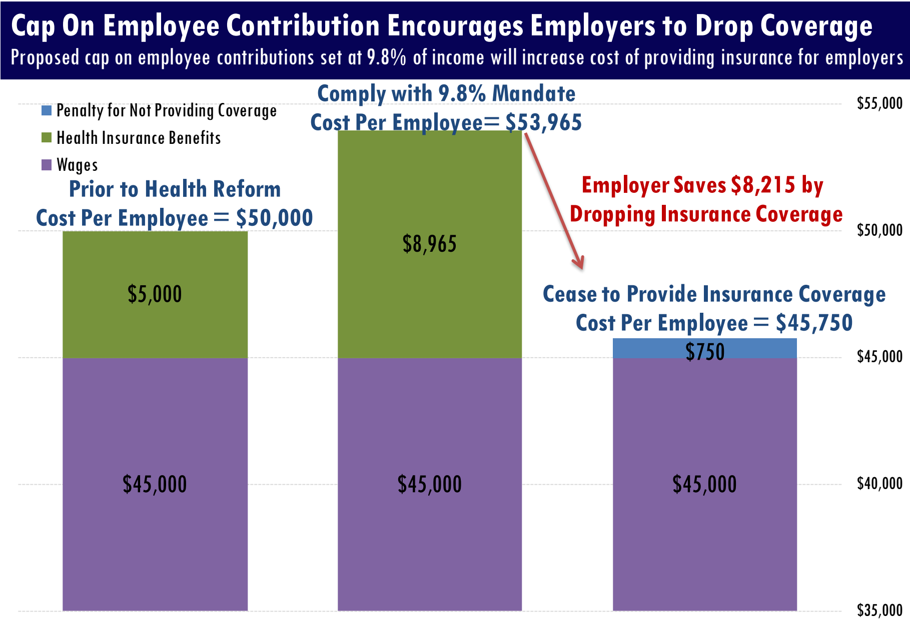
4 *Fourth in a series*

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 would make it much more costly for employers to offer health benefits.*

CASE # 4: DISINCENTIVES TO OFFER HEALTH BENEFITS

9.8% Cap on Employee Contributions Encourage Employers to Eliminate Insurance Coverage

The Senate bill would cap employee contributions to insurance premiums at 9.8% of their income. If an employer offered a policy that required employees to pay more than this, the employee would be eligible to purchase insurance through the exchange, and the employer would have to pay a fine equal to the lesser of $3,000 per employee who enters the exchange or $750 times their total number of employees. If an employer currently contributes $5,000 (the cost of an average single policy in 2009) towards each of his or her employees' insurance premiums, an employee with median earnings of $45,000 per year will pay



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

$8,375 for a family health insurance policy with a total cost of $13,375.[2] This contribution, however, represents 19% of the employee's income. To bring the employee contribution down to 9.8% of their income, the employer will have to increase its contribution by $3,965 to a total of $8,965. Clearly, the incentive here is for the employer to drop its offer of employer sponsored health insurance coverage and pay a $3,000 fine rather than $3,965 in additional health insurance costs (by dropping coverage, the employer will also save the $5,000 insurance contribution they previously made).

For employers paying low- to moderate wages, there is a strong incentive to eliminate insurance coverage altogether. If the employer has 60 employees each with salaries of $45,000, and half of these employees have family health insurance coverage, the 9.8% cap on employee contributions would result in an additional cost of $118,950 to the employer. Rather than pay the additional insurance costs, the employer could instead drop employee coverage and pay a $45,000 penalty (60 employees x $750 = $45,000). By ceasing to offer its employees health insurance coverage, the employer saves a total of $73,950 plus the $5,000 per employee ($300,000 total) that it previously contributed towards health insurance. In return for the savings from not offering coverage, the employer will presumably increase the compensation of the employee by roughly $5,000 ($300,000 total) and the employee will use the money to either pay the $750 per adult penalty for not having insurance or to purchase insurance in the exchange, but will lose the benefit of being able to pay for insurance with tax-free dollars.

High Cost Plans Tax Discourages Employers from Offering FSAs

Under the Senate Democrats' bill, Flexible Spending Account (FSA) contributions (as well as dental and vision plans) will be included in the total cost of employees' health insurance benefits for the purpose of calculating the high cost plans tax. This 40% tax on providers of high cost health insurance plans will apply to plans above $8,500 for individuals and $23,000 for families, beginning in 2013.[3] While a particular health insurance plan, in and of itself, may not exceed the threshold, adding on an FSA contribution and dental or vision benefits could push the total cost of health benefits above the high cost threshold.

For example, consider an individual plan that costs $8,000, and the individual makes an FSA contribution of $2,500. The total cost of the employee's health benefits is $10,500, which exceeds the $8,500 threshold by $2,000. Therefore, an $800 tax (40% of $2,000) is due. But who pays the tax—the insurance company or the FSA sponsor (i.e., the employer)? Because there are multiple health benefits, the tax is distributed proportionally to the sponsors of the benefits. In this case, the employer would be responsible for paying $192 (24%) of the tax. If the employee were only allowed to contribute $500 to an FSA, the employer could avoid this tax. But if employers limit FSA contributions, employees' taxable wages will rise and they will pay higher payroll and income taxes. As more and more plans become subject to the high cost plans tax (due to a lack of appropriate indexing as well as costly new benefit mandates) it will be in employers' best interest to eliminate FSA offerings altogether.

---

[2] The median earnings of a full-time, year-round male earner in 2007 was $45,113 (U.S. Census Bureau). The average family premium in 2009 was $13,375, and the average single premium in 2009 was $4,824 (Kaiser Family Foundation).

[3] For retirees over age 55 and employees in high risk professions, the thresholds will be $1,450 higher for individuals and $3,000 higher for families. In the first years of the bill, transition relief will be provided, in the form of higher thresholds, to the 17 highest-cost states.