

14.472 Public Finance II

Health Insurance Reform

Amy Finkelstein

Fall 2024

Outline

- Incremental reform:
 - Tax subsidy to employer provided health insurance
 - Redistribution: Cash transfers vs. Health Insurance
- Radical reform:
 - Einav and Finkelstein “We’ve Got You Covered”

Tax Subsidy to Employer Provided Health Insurance

- Employer contributions to health insurance exempt from federal tax
- The tax subsidy (s) to employer-financed health insurance s is thus:

$$s = 1 - \left(\frac{1 - \tau_{inc} - \tau_{SS}}{1 + \tau_{SS}} \right)$$

- τ_{inc} : employee's marginal tax rate on earning income,
 - τ_{SS} : statutory payroll tax rate for the employee (and separately for employer)
 - If the employee is paid a dollar in wages, he must pay both income tax and payroll tax on that wage, and the employer must also pay payroll tax on it.
 - Costs employer $1/(1 + \tau_{SS})$ to provide the employee with $1 - \tau_{inc} - \tau_{SS}$ in take home pay, or a dollar contribution to health insurance premiums
- For a worker earning \$50,000 a year in 2019, tax subsidy is about 35 percent

Tax Exclusion

- Largest federal tax expenditure (\$172.8 billion in 2019)
- Historical origins: WWI
 - Wages subject to income and payroll taxation, compensation paid in the form of contributions to health insurance premia are not.
 - Large literature showing that tax exclusion critical for encouraging employer-provided health insurance (e.g. Thomasson AER 2003; Gruber TPE 2002)
- Potential benefit: bundling (recall adverse selection)
- Potential costs... many...

Tax Exclusion: Downsides

- Distorts compensation toward health insurance vs. wages; creates so-called gold-plated health insurance
 - Feldstein (1973 JPE); Gruber (2002 TPE)
- Regressive – Tax rates rise with income (so does employer offering of health insurance)
- Bundling health insurance with labor market
 - Creates ‘job lock’ (e.g. Gruber and Madrian 2004; Garthwaite et al. QJE 2014)
 - Contributes to rising labor market inequality

Health Insurance and Labor Market Inequality

- Financing of employer-provided health insurance functions as a `flat' head tax on hiring, independent of earnings
 - “Because health insurance premiums are fixed, the wage penalty is the same for a low-wage secretary as it is for a highly paid executive..... It's the most unfair type of tax” - Saez and Zucman
- Discourages hiring of lower-skilled workers
 - “Employer-based health insurance is a wrecking ball, destroying the labor market for less-educated workers” - Case and Deaton
- Quantitative importance (Finkelstein et al. BPEA 2023)
 - Calibrated, stylized model of labor market
 - If financed by proportional (payroll) tax on earnings, college wage premium would be ~11% lower, non-college employment would be ~500,000 higher
 - Comparable to impacts of outsourcing, robots, trade and declining unionization on labor market inequality

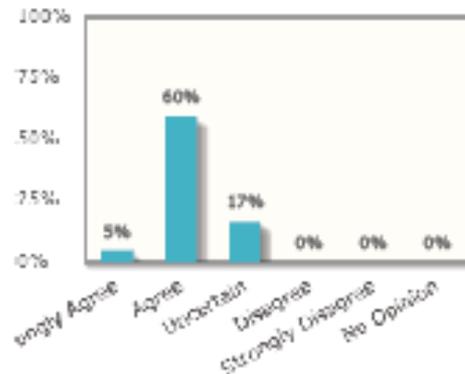
Tax Exclusion: Universally Reviled (By Economists)

Tuesday, May 17th, 2016 1:44 pm

Cadillac Tax

The “Cadillac tax” on expensive employer-provided health insurance plans will reduce costly distortions in US health care if it is allowed to take effect as scheduled in 2018.

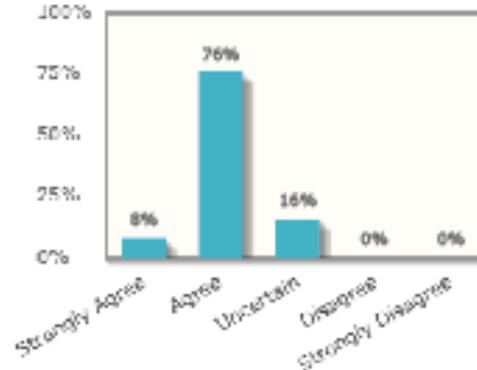
Responses



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Responses weighted by each expert's confidence



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“If we had to do it over again, no policy analyst would recommend this model” - Uwe Reinhardt.

Cash Transfers vs. Subsidized Health Insurance for Low Income Individuals

- Recall last lecture: Medicaid vs. EITC as redistribution

The New York Times

ECONOMIC VIEW

*Why cash is better than
expanded health insurance
for the poor*

By Amy Finkelstein

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Research Question Wish List (from book)

- Delivery reform: Optimal delivery reform / design
 - Huge question (w little in the way of answers) in both US and other countries
- Impact of private provision (or private insurance) on public insurance / basic system (complements or substitutes)
- Impacts of coverage uncertainty
- Long term care (social insurance or medical insurance?)

HAPPY THANKSGIVING!

