The Heritage Foundation Backgrounder
Executive Summary

No. 1420 March 16, 2001

How Health Tax Credits for Families Would Supplement Employment-Based Coverage

Stuart M. Butler, Ph.D.

A number of legislative proposals on Capitol Hill would provide uninsured workers with a tax credit to help them purchase health insurance. The most recent was introduced on March 14 by Senators John Breaux (D–LA) and James Jeffords (R–VT). President Bush has proposed a similar credit. Such proposals have prompted some to argue that a better way to increase the rate of insurance would be to subsidize employers. Supporters of this view maintain that employment-sponsored health plans are popular and practical, and that subsidizing employers rather than families would therefore be a better way to cover uninsured families.

This view, however, fails to recognize the inherent limitation of traditional employer-sponsored insurance. While it usually does make sense for large, sophisticated employers to sponsor insurance—in other words, to arrange coverage—it is administratively costly and inefficient for small employers to try to sponsor health plans. Small firms also can rarely offer plan choices to their employees and tailor coverage to worker needs. Subsidizing these small employers would not overcome these drawbacks.

What is needed is a variant of employment-based coverage for certain groups of workers, especially employees of small firms among whom the rate of uninsurance is particularly high. Crafting such a variant requires lawmakers to recognize that:

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- Providing tax credits to employers rather than families would not solve the uninsurance problem.
- Automatic enrollment could be used to boost coverage.
- Although the place of work may be the best location through which most families can get coverage, employers are not necessarily the best sponsors of coverage.

- Individual tax credits could make large corporate health plans available to non-employees.
- Tax credits can easily be made available to families when payments are due.
- Credits would make it possible for plans to be offered through churches, unions, and other associations, as well as through the Federal Employees Health Benefits Program (FEHBP).
- Congress can protect traditional employer-sponsored coverage.

The obstacles to employment-based coverage in the small-business sector help to explain the high level of uninsurance among families with workers in that sector. According to a recent Kaiser Foundation survey, 74 percent of the uninsured are in families with at least one full-time worker; while 99 percent of large firms offer insurance, only 55 of firms with fewer than 10 employees do so; and among low-wage workers (those who earned less than $7 an hour in 1996), 45 percent are not even offered insurance.

The limitations of small firms as sponsors of insurance reveal the weakness of proposals that would subsidize to cover the uninsured. Credits or other subsidies for employers do not make small firms good risk pools. Even though a subsidy would help to offset the high administrative costs borne by small employers, it would not make administration more efficient or sophisticated. Nor would a subsidy deal with the "hassle factor" that causes so many small-business owners to compete for workers by giving cash instead of complex benefits.

Tax credits for employers—in contrast to tax credits for employees—are also very difficult to target efficiently. If the government wishes to help lower-income families to afford insurance, it can use eligibility criteria based on family income; but if it tries to do this by means of a credit for employers, there is the problem of assuring that the subsidy supports coverage only for those who really need assistance.

Simply providing a subsidy to all small businesses would not do this, since the taxpayer would end up subsidizing the coverage of many well-paid lawyers, doctors, computer engineers, and others who work for small firms. Yet trying to limit subsidies to the costs of covering lower-income households would require employers to determine the household income of their employees, which would be a burden and also would raise issues of privacy and potential fraud.

Individual tax credits would allow the employment-based system to evolve in a way that would better meet the needs of working families. They also would allow traditional employer-sponsored insurance to continue for most workers and even make it available to additional families. But a system of credits for families also would encourage the simultaneous development of a slightly different system, primarily for uninsured workers in small firms.

Proposals for individual tax credits for health coverage, such as those advanced by President Bush and bipartisan groups of lawmakers on Capitol Hill, would help remove the barriers to alternative insurance arrangements and make new forms of coverage—including plans offered through churches, large corporations, and the FEHBP—available to working Americans. For this to occur, however, Congress must recognize the important distinction between the place of employment as the convenient place to obtain insurance and making tax relief to families contingent upon employer sponsorship of their health insurance.

—Stuart M. Butler, Ph.D., is Vice President for Domestic and Economic Policy Studies at The Heritage Foundation.

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A number of legislative proposals on Capitol Hill would provide uninsured workers with a tax credit to help them purchase health insurance.[1] The most recent was introduced on March 14 by Senators John Breaux (D–LA) and James Jeffords (R–VT).[2] President George W. Bush has proposed a similar tax credit.

Such proposals for individual tax credits have prompted some to argue that a better way to increase the rate of insurance would be to subsidize employers, perhaps through special targeted tax credits directed to employers to induce them to provide affordable coverage to the uninsured. Supporters of this view maintain that employment-sponsored health plans are popular and practical, and that subsidizing employers rather than families would therefore be a better way to cover uninsured families.

This view, however, fails to recognize the inherent limitation of traditional employer-sponsored insurance. While it usually does make sense for large, sophisticated employers to sponsor insurance—in other words, to arrange coverage—it is administratively costly and inefficient for small employers to try to sponsor health plans. Small firms also can rarely offer plan choices to their employees and tailor coverage to worker needs. Subsidizing these small employers would not overcome these drawbacks.

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What is needed is a variant of employment-based coverage for certain groups of workers,

1. For descriptions of various forms of the tax credit approach, see James Frogue, "A Guide to Tax Credits for the Uninsured," Heritage Foundation *Backgrounder* No. 1365, May 4, 2000, available at *http://www.heritage.org/library/backgrounder/bg1365es.html*.

2. Co-sponsors include Senators Tom Carper (D–DL), Lincoln Chafee (R–RI), William Frist (R–TN), Blanche Lincoln (D–AR), and Olympia Snowe (R–ME).

especially employees of small firms among whom the rate of uninsurance is particularly high. Crafting such a variant requires lawmakers to recognize that:

- Providing tax credits to employers rather than families would not solve the uninsurance problem.
- Automatic enrollment could be used to boost coverage.
- Although the place of work may be the best location through which most families can get coverage, employers are not necessarily the best sponsors of coverage.
- Individual tax credits could make large corporate health plans available to non-employees.
- Tax credits can easily be made available to families when payments are due.
- Credits would make it possible for plans to be offered through churches, unions, and other associations, as well as through the Federal Employees Health Benefits Program (FEHBP).
- Congress can protect traditional employer-sponsored coverage.

Introducing individual tax credits would allow the employment-based system to evolve in a way that would better meet the needs of working families. Individual tax credits would allow traditional employer-sponsored insurance to continue for most workers and would even make it available to additional families. But a system of credits for families also would encourage the simultaneous development of a slightly different system, primarily for uninsured workers in small firms.

WHY EMPLOYER-SPONSORED INSURANCE IS POPULAR AND OFTEN MAKES SENSE

Popularity of Employer-Sponsored Insurance. Surveys indicate that working Americans generally prefer employer-based health coverage to other ways of acquiring health insurance. There are several reasons for the popularity of employer-sponsored coverage.

- **Employees often view benefits as somehow free because the employer "pays for" coverage.** Workers who receive health insurance from their employer often think of it as a free or subsidized benefit that adds to their total compensation. Faced with a choice between having the employer pay for coverage (even if it is less than ideal) or having to pay for it themselves, workers understandably prefer that the employer pay. But this vision of employer-sponsored coverage rests on an illusion. Employers are not charities, and as economists point out, health care and other fringe benefits are really substitutes for cash compensation and therefore are substantially paid for by the employee.[3] Thus, part of the attraction of employer-sponsored coverage is based on a misunderstanding by workers about who is really paying for insurance.
- **Employment-based coverage is the only way for most families to obtain a very large tax benefit for insurance costs.** When part of a worker's compensation is provided in the form of health insurance, the value of that compensation is exempt from all income and payroll taxes. The total value of this so-called tax exclusion is about $125 billion each year in federal and state income taxes, and payroll taxes.[4] For an insured family with an annual income of over $100,000, the average value of the tax benefit is well over $2,000. For lower-income but insured families, it is a small fraction of that amount because their marginal tax rate is lower. And if an uninsured person were to buy coverage for himself and his family, he normally would receive no tax benefits at all. It is therefore not surprising that Americans

3. Various studies have found that, depending on the industry, between 56 percent and 85 percent of insurance costs are passed back to employees in reduced wages. See Linda J. Blumberg, "Who Pays for Employer-Sponsored Insurance," *Health Affairs*, Vol. 18, No. 6 (November/December 1999), p. 58.
4. John Sheils and Paul Hogan, "Cost of Tax-Exempt Health Benefits in 1998," *Health Affairs*, Vol. 18, No. 2 (March/April 1999), p. 178.

prefer a way of providing coverage that gives them a tax break—and for some, a very large break.

- **Employment-based insurance is very convenient.** When an employer provides coverage, it is normally very easy for an employee to take part in the plan. Premiums are paid directly by the employer, and the worker does not have to apply for a tax exclusion; the W–2 form, indicating the worker's income for tax purposes, simply makes no mention of the value of the employer's contribution to his health insurance. Moreover, if the worker has to pay something toward the cost of his plan, this is usually done in the form of a convenient payroll deduction during each pay period.

Technical Benefits

Besides these preferences expressed by workers, there are technical reasons why it usually makes good sense for large companies to sponsor health insurance.[5]

- **Pooling.** A company with a large work force obviously also has a large pool for insurance purposes. Hence, a large number of individuals can be grouped together and insured as a group for a standard premium, despite possibly wide variations in medical risks among employees. Large companies also have the economies of scale and sophistication to provide insurance at a low administrative cost per employee.
- **Advantages for bargaining and administration.** Larger companies also can bargain very effectively with insurers and providers, and so are able to deliver cost-effective coverage that is often tailored specifically for their work force.
- **Choice.** Because of the size of their insurance pool and their sophistication, large companies can arrange a choice of health plans, making it more likely that workers will be reasonably satisfied with their coverage.

OBSTACLES TO SMALL EMPLOYERS OFFERING INSURANCE

While these advantages of employer-sponsored coverage certainly apply to workers in many firms, they are less likely to apply to certain specific categories of workers, especially those employed in small firms.[6] Among the reasons for this are the following:

- **Small firms by definition are small insurance pools.** A retail store with a handful of employees is a dismal pool for insurance purposes. Hiring a new employee with a disability, for example, or the diagnosis of a chronic heart problem in an older worker can mean a huge change in insurance costs for the employer. States and the federal government recognize this and are exploring various ways to group small firms together to form larger insurance pools. But the need for these efforts only underscores the fact that the place of employment is not a particularly good basis for the pooling of these insurance risks for employees of small firms.
- **Small firms face relatively high administrative costs, and many small-business owners do not wish to organize insurance.** Because they lack the economies of scale and the management resources of larger firms, small businesses tend to face high costs when administering plans. According to data collected by the Congressional Budget Office, overhead costs for providing insurance can be over 30 percent of premium costs for firms with fewer than 10 employees, compared with about 12 percent for firms with more than 500 employees.[7] Moreover, many small-business owners have little desire to engage in the demanding task of trying to organize health

5. For a summary of the advantages of employer-sponsored coverage, see William S. Custer, Charles N. Kahn III, and Thomas F. Wildsmith IV, "Why We Should Keep the Employment-Based Health Insurance System," *Health Affairs*, Vol. 18, No. 6 (November/December 1999), pp. 115–122.
6. For a summary of the pros and cons of employer-sponsored coverage, see Uwe E. Reinhardt, "Employer-Based Insurance: A Balance Sheet," *Health Affairs*, Vol. 18, No. 6 (November/December 1999), pp. 124–132.

insurance that meets the often varied needs of their employees.

- **Small firms can rarely offer a choice of plans.** If a small employer provides coverage, it tends to be a single "one-size-fits-all" plan. Small companies rarely offer a choice of plans. While 81 percent of workers with insurance in firms of 5,000 or more employees had a choice of at least three plans in 2000, only 2 percent of covered workers in companies with fewer than 25 employees had a similar choice of at least three plans. Meanwhile, 95 percent of covered workers in the smaller companies had only one plan available to them.[8]

The Result: High Rates of Uninsurance in Small Firms

These obstacles to employment-based coverage in the small-business sector help to explain the high level of uninsurance among families with workers in that sector. According to a recent survey by the Kaiser Foundation, 74 percent of the uninsured are in families with at least one full-time worker, and while 99 percent of large firms offer insurance, only 55 of firms with fewer than 10 employees do so. Among low-wage workers (defined as those who earned less than $7 an hour in 1996), 45 percent are not even offered insurance.[9]

WHY A TAX CREDIT FOR EMPLOYERS IS NOT THE ANSWER

The limitations of small firms as sponsors of insurance reveal the weakness of proposals that would subsidize to cover the uninsured. Credits or other subsidies for employers do not make small firms good risk pools. Even though a subsidy would help to offset the high administrative costs borne by small employers, it would not make administration more efficient or sophisticated. Nor would a subsidy deal with the "hassle factor" that causes so many small-business owners to compete for workers by giving cash instead of complex benefits.

Tax credits for employers—in contrast to tax credits for employees—are also very difficult to target efficiently. If the government wishes to help lower-income families to afford insurance, it can use eligibility criteria based on family income; but if it tries to do this by means of a credit for employers, there is the problem of assuring that the subsidy supports coverage only for those who really need assistance. Simply providing a subsidy to all small businesses would not do this, since the taxpayer would end up subsidizing the coverage of many well-paid lawyers, doctors, computer engineers, and others who work for small firms. Yet trying to limit subsidies to the costs of covering lower-income households would require employers to determine the household income of their employees, which would be a burden and also would raise issues of privacy and potential fraud.

The Folly of the Common Ground Proposal. The targeting problems associated with a tax credit for employers can be seen in the "Common Ground" proposal, an approach to dealing with uninsurance recently advanced by a group of organizations headed by Families USA and the Health Insurance Association of America (HIAA). In trying to restrict the credit only to expanded coverage for lower-income households, the credit calculation becomes very complex for business owners and fraught with potential legal problems. According to the authors of the plan:

> The credit would be available to those employers that pay a larger share of the premium (than what is offered to other workers in the company) for workers with family incomes between 133 and 200 percent of poverty. For example, if a business currently pays 70 percent of the premiums for all workers and decides to

7. Congressional Budget Office, *The Tax Treatment of Employment-Based Health Insurance*, 1994, p. 8.
8. Kaiser Family Foundation and Health Research and Educational Trust, *Employer Health Benefits, 2000* (Menlo Park, Cal.: Kaiser Family Foundation, 2000), p. 57.
9. Kaiser Commission on Medicaid and the Uninsured, *Uninsured in America: Key Facts* (Washington, D.C.: Kaiser Family Foundation, 2000).

> pay all or part of the remaining premium for low-income workers, that business would receive a tax credit for that additional amount. The employer tax credit would be available only to companies that make contributions to their health plans commensurate with the contribution levels of other similarly situated employers.[10]

One of the most significant problems with this mechanism, quite separate from its complexity and paperwork burden, is the difficulty of assessing family income. To be sure, the employer has a record of the worker's income, but a low worker's income does not necessarily mean a low household income. For instance, the worker may be a second earner who earns substantially less than his or her spouse. Basing the credit only on the worker's income thus could mean subsidizing coverage for middle-income or even upper-income households.

Basing the credit on total family income, however, means that each potentially eligible family would have to provide its employer with complete income information—a significant invasion of privacy. Moreover, the financial incentive for both employer and worker to understate household income in order to establish eligibility would invite fraud and therefore would require careful audits by the government. If such an audit discovered that an employer had claimed a credit inappropriately, it would be difficult to know whether the employer had committed fraud or had simply been supplied erroneous income information by the worker. This legal jeopardy would discourage many employers from claiming the credit.

DESIGNING AN ALTERNATIVE FOR THE UNINSURED

The inherent problems that characterize employment based coverage have induced a number of analysts and lawmakers to suggest providing tax credits directly to individuals to help uninsured families pay for coverage, either sponsored by their employer or obtained from another source.[11] Some proposals would provide a credit of a specific amount; others, a credit based on some proportion of the premium's cost to the family. Most would restrict the credit to households below a certain income and typically would make the credit refundable, meaning that if the eligible credit exceeded the taxes otherwise paid by the family, the household would receive a direct payment from the government.

The central features of these proposals are that the tax credit would go to the family, not the employer, and would not be confined to traditional employer-sponsored coverage. Thus, the responsibility for demonstrating eligibility also would rest with the family, not the employer.

As Congress considers health care tax credits for families, it is important for lawmakers to keep certain things in mind.

1. **The place of work may be the best location through which most families can get coverage, but employers are not necessarily the best sponsors of coverage.**

Most people in America pay their taxes through a place of work. This is a very convenient system under which employers withhold income and Social Security taxes and send the money to the government. In addition, employees typically adjust their withholdings to take advantage of any tax breaks for which they may be eligible (for example, the mortgage interest deduction). In a sense, this means that employers actually operate the basic income tax system; but they do not in any sense design the tax code for their employees or "sponsor" the tax system. They could more appropriately be considered a clearinghouse for tax payments.

The place of employment is likewise particularly convenient and efficient for handling health insurance payments. Workers with employer-

10. Charles N. Kahn III and Ronald F. Pollock, "Building a Consensus for Expanding Health Coverage," *Health Affairs*, Vol. 20, No. 1 (January/February 2001), pp. 45–46.

11. Frogue, "A Guide to Tax Credits for the Uninsured."

sponsored health insurance benefits typically sign up for the firm's plan when they take a job and arrange for a payroll deduction to cover premium costs for them or their family. With individual tax credits available, employers currently sponsoring insurance could continue to do so, but workers eligible for the credit (in most proposals, low-income employees) could use the credit to help pay for their share of the premium. This would make traditional employer-sponsored coverage more affordable for many workers.

Individual tax credits also mean that an employer who is reluctant to sponsor coverage could still carry out the critical clearinghouse role for plan choices, tax adjustments, and premium payments. Such employers would no longer be required to organize or sponsor a plan for their employees to obtain tax relief for the cost of coverage—or financial contributions made by the employer.

In other words, smaller employers could handle the mechanical aspects of arranging for payroll deductions and premium payments (similar to their role in the tax collection system) without having to sponsor a plan. With individual credits, eligible employees could join any plan available in their area, not just one sponsored by their employer, and still obtain tax benefits. Thus, the employer could play a very important role in facilitating coverage without having to organize coverage. Moreover, with the credit not restricted to employer-sponsored coverage, eligible workers could enjoy a wide choice of plans.

2. **Tax credits can easily be made available to families when payments are due.**

It is sometimes said that individual credits would not work for low-income workers because they could not wait until the end of the year for the credit. It is also argued that many workers who today do not make enough to file a tax return would have to start filing a return just to obtain these credits. Both arguments are spurious.

Delivering the credit through the withholding system. The simplest way to deliver the subsidy to workers would be through an adjustment in tax withholdings, much as deductions (such as mortgage interest) or credits (such as the child care credit) are typically handled today with the employer remitting tax payments to the government that are net of the credits. This means that workers would receive the tax benefit in increments throughout the year when they receive their paychecks.

Employers also could institute a system of payroll deductions for health premiums, perhaps through the existing rules for flexible benefit plans, so that money would be available when premiums were due. Employers could pay premiums directly from these accounts on behalf of employees. In this way, the credit–premium transaction would be relatively simple for both employer and employee.

An alternative: assigning the credit to a health plan. Another option would be to permit families to assign the value of their credit to their insurance plan in return for a lower premium. With assignment, the employee signs a document allowing the insurer to claim the credit on his behalf, and the insurer agrees to reduce premiums by the same amount. Insurers normally would obtain the credit through an adjustment in their tax payments to the government. Thus, rather than deal with the withholding system, a family would have only to establish its eligibility for a fixed or simple percentage credit.

This alternative would be particularly attractive to those lower-income families that do not even file tax returns, and would also be another way to deal with the concern that the tax subsidy might not be available when premiums are due. The process would mirror the premium payment system in the Federal Employees Health Benefits Program, under which Members of Congress and other federal employees are quoted premiums net of the government contribution.

3. **Automatic enrollment could be used to boost coverage.**

Whether or not they sponsored insurance, employers could institute an automatic enrollment and payment system to make health insurance premium payments and obtain health-related tax benefits. This means that employees would automatically be enrolled in a health plan unless they explicitly declined to do so, perhaps by signing a document indicating that they understood the possible consequences of not enrolling in a plan. Alternatively, a state could establish a default bare-bones health plan in conjunction with a private insurer, to which anyone not otherwise choosing a plan would be assigned.

In addition, as noted earlier, employers could establish a payroll deduction and premium payment system for employees, structured much like the flexible spending plans operated voluntarily by many employers. The employer could then make a payment to the insurer on behalf of the employee—or, more likely, a payroll company would handle the entire transaction for a small firm. Employers would not have to sponsor the insurance themselves for such a system to operate; the key is to provide a tax benefit to the employee even though the employer is not the plan sponsor. The proposed tax credit measures would do this.

Evidence from pension plans indicates that an automatic enrollment system for health insurance could have dramatic effects on sign-up rates.[12] This payment system is also very similar to the way in which the FEHBP enables a federal worker who may work in a small workplace, such as the local office of a Member of Congress, to choose from possibly dozens of plans.

4. Individual tax credits could make large corporate health plans available to non-employees.

Tax credits to individuals would remove the current tax barrier to large corporations' marketing their health plans widely to non-employees. This could mean major and attractive new options, especially for the uninsured and for the workers employed by very small firms.

It is quite common for large firms to take products developed initially as an internal service to the firm and market them to external customers. For example, General Motors formed the General Motors Acceptance Corporation (GMAC) out of its huge automobile loan service and markets a broad range of financial services to non-employees. It is even possible for people with no connection to General Motors to finance their house with a mortgage from GM.

But this does not happen with health insurance. The main reason: While the tax system does not deny the mortgage interest deduction to someone obtaining a mortgage from a car company, it does not normally give tax relief to individuals or non-employment groups signing up for health plans offered by another employer. The only way such individuals could gain access to these large corporate plans would be for the corporation to reach an agreement with the individual's employer to manage the smaller firm's health insurance. (Daimler–Chrysler is exploring such an arrangement with its suppliers.)

An individual tax credit would remove this obstacle, allowing families to join any health plan while claiming the credit. This would dramatically change the incentives in the current market, opening up a potentially large new market for existing corporate plans and an opportunity for many working families to obtain coverage under these plans.

One firm whose activities hint at what could happen in a more liberalized environment is the John Deere Company. Intent on improving the health care of its own employees while reducing costs, the company several years ago created its own Health Maintenance Organization (HMO). It then began to offer coverage to other employers and purchased health operations to serve its new market.

The company, however, has not confined itself to offering its expertise and facilities only to employer groups. Its for-profit health division, John Deere Health Care, also offers coverage to individuals as a Medicare HMO and provides managed care Medicaid services in several states. The Deere Plan is also available to some federal workers under the FEHBP. Out of more than

12. A recent study found that automatic enrollment for 401(k) plans boosted participation rates from 37 percent to 86 percent for such voluntary pensions, with even sharper increases for young and lower-paid employees. See Brigitte Madrian and Dennis Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, National Bureau of Economic Research *Working Paper* No. 7682, May 2000, p. 51.

400,000 enrolled in Deere plans in the Midwest and Southeast, less than 20 percent are John Deere employees. The tax code, however, makes it very uneconomic for Deere to offer coverage to groups of working families (except federal workers) other than through their employer.

With a tax and regulatory system that was more conducive to entrepreneurship by corporate health plans, one could imagine a surge of new ventures by existing corporate plans, reminiscent of similar patterns when restrictions on spin-off ventures in other industries were removed.

5. Credits would make it possible for plans to be offered through churches, unions, and other associations, as well as through the FEHBP.

Individual tax credits would also make it much more practical and economic for families to obtain insurance through large organizations with which they are affiliated rather than being confined to employer-sponsored plans. By obtaining insurance through large organizations, workers in small firms could obtain many of the administrative economies of scale and large insurance pools now normally available only to the employees of large firms.

These organizations could offer insurance plans alongside traditional employer-sponsored coverage. Typically, they would not get into the business of insurance themselves, but would act much as a buyers club does by negotiating an arrangement with existing insurance companies. Organizations such as churches, the American Association of Retired Persons (AARP), professional and trade associations, farm bureaus, and credit unions could reach agreements with health plans.

Some organizations (for example, many farm bureaus) already offer plans, but working families joining these plans typically are not eligible for tax relief. Tax credits for health insurance would change that. Many African–American church congregations have organized insurance and other services for their members for years. Moreover, in many inner-city communities, these churches are typically larger, more stable, and more sophisticated—as well as more trusted—than the typical employer, making them a natural avenue through which many families armed with tax credits could obtain their health insurance.

In recent years, there have been proposals at the federal level that would create new kinds of associations that would be freed from many federal and state restrictions, particularly state benefit mandates. The most important of these are Health Marts and Association Health Plans. These reforms would make it easier for organizations to offer coverage to individuals or groups.[13]

The Federal Employees Health Benefits Program offers federal workers and their dependents and insurers (the equivalent of a small country: nearly 10 million covered individuals) a wide choice of plans.[14] The FEHBP is a generally successful system that operates in parallel to the systems available to workers outside the federal government, and there have been several proposals to open it to non-federal workers under various conditions, typically using a separate insurance pool.[15]

To make the FEHBP available to non-federal workers using tax credits, federal law governing the FEHBP would be amended to permit a separate insurance pool for non-federal employees. Plans currently available in the FEHBP would be allowed to market to the new pool, if they wished, and other plans could market exclusively to the new pool provided they met the general requirements of the FEHBP.

13. See James Frogue, "The Shadegg Health Bill: Expanding Access and Choice," Heritage Foundation *Backgrounder* No. 598, May 19, 1999.

14. For a description of the FEHBP, see Harry Cain, "Moving Medicare to the FEHBP, or How to Make an Elephant Fly," *Health Affairs*, Vol. 18, No. 4 (July/August 1999) pp. 25–39; Stuart Butler and Robert Moffit, "The FEHBP as a Model for a New Medicare Program," *Health Affairs*, Vol. 14, No. 4 (Winter 1995); Craig Caplan and Lisa Foley, *Structuring Health Care Benefits: A Comparison of Medicare and the FEHBP* (Washington, D.C.: AARP Public Policy Institute, May 2000).

15. For instance, Senator Bill Bradley (D–NJ) made such a proposal during his 2000 presidential campaign.

Similarly, the "friendly society" role of unions has a long history in this and other countries. In markets where there are fewer tax and regulatory obstacles to union-sponsored plans, they exist and indeed flourish. Several of the leading FEHBP plans are organized by unions; the Mail Handlers, for example, even offers associate membership to non-union members who wish to gain access to the health plan. Indeed, the Mail Handlers Benefit Plan, backed by CNA Insurance, has roughly 10 times as many enrollees as the union has regular union members.

These unions do not carry the insurance risk themselves; instead, they organize a group and negotiate an insurance package from an insurer for a fee. Many union-sponsored plans also operate under the Taft–Hartley Act, where union-sponsored plans are a rational way to provide coverage when there is only a weak relationship between employer and worker. Changing the federal rules governing such plans and making a tax credit available for families to purchase insurance directly could lead to an expansion of union-sponsored plans.

6. Congress can protect traditional employer-sponsored coverage.

While Americans want to help the uninsured, they do not want to do so at the risk of losing what they already have. For the more than 170 million Americans who rely on job-based health insurance, as well as their companies and insurers, this means that any reform to help the uninsured should create a system that parallels what is already in place rather than supplanting it.

Large, medium, and some small businesses see their ability to offer health coverage as part of their competitive advantage in gaining and keeping workers. Even though the satisfaction level with job-based coverage is steadily eroding, workers nevertheless have a level of security with the coverage they already have and do not want it to be disrupted.

Concerns that actions to help the uninsured could undermine the traditional employment-based system are not unique to tax credits. Any program to help the uninsured, including the expansion of government programs, poses competition to parts of the employer-sponsored system. To reduce the possible erosion of the existing employer-sponsored system, Congress could restrict eligibility to those who are not offered insurance through their place of work. It also—if employer-sponsored insurance is available—would require that the credit be used to purchase a plan offered by the employer.

The response of some small employers doubtless would be to convert health benefits into cash income or into a defined cash contribution to a plan chosen by the employee, but this would be a benign form of "unraveling" since employees would now have more income and tax benefits with which to choose the plans they want. This effect would also be offset as currently uninsured families in other firms used their credit to buy into their employer's plan.

CONCLUSION

Uninsurance among working families is testament to the limitations of the employment-based health system, especially in the small-business sector. Yet the tax system discourages other insurance arrangements from serving the uninsured.

Proposals for individual tax credits for health coverage, such as those advanced by President Bush and bipartisan groups of lawmakers on Capitol Hill, would help remove this barrier to alternative insurance arrangements. With this reform in place, new forms of coverage—including plans offered through churches, large corporations, and the FEHBP—would become available to working Americans. For this to occur, however, Congress must recognize that an important distinction exists between the place of employment as the convenient place to obtain insurance and making tax relief to families contingent upon employer sponsorship of their health insurance.

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