Backgrounder

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Building on the President's Health Care Agenda

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President George W. Bush made health care a key piece of his budget proposal for fiscal year 2007, outlining a variety of initiatives focused on improving "the Nation's health care system by making it more affordable, transparent, portable, and efficient."[1] The President accurately articulates the problems facing today's health care system, lays out a clear vision for the future, and proposes various policy initiatives to reach those goals. Members of Congress should seize this opportunity and build on the policy foundation set forth by the President.

The President's Vision

President Bush envisions a better health care system in the 21st century for all Americans. This better system would be based on personal choice, individual ownership of health insurance, and genuine free-market competition among plans and providers. The President aims to increase personal freedom by:

- Establishing tax equity in health care;
- Promoting health insurance portability;
- Expanding health coverage options;
- Improving health savings accounts (HSAs); and
- Advancing information access, prevention, and better medical liability laws.

The President's vision is the right one, but it differs in some respects from the program that he outlined during his 2004 presidential election campaign.[2] Congress should enact specific policy changes that are consistent with that vision and that would fulfill its promises.

Talking Points

- The President has laid out a clear vision for the future of America's health care system that is based on establishing tax equity, promoting portability, expanding coverage options, improving health savings accounts (HSAs), and advancing efforts on information, prevention, and medical liability reform.
- However, some of the key policy proposals put forth by the Administration to reflect this vision, such as focusing on tax equity and portability solely for HSA high-deductible health plans, are limited in their scope and application.
- Congress should build on the principles of the President's vision but broaden the scope and application of the policy recommendations.
- Specifically, Congress should expand the efforts to create tax equity and portability by applying such initiatives to all health plans and giving individuals the ability to choose the coverage that best fits their personal needs and preferences.

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However, Congress should be bolder than the White House and broaden the scope of change well beyond the President's specific policy recommendations by:

- Expanding the proposed tax provisions to cover all health plans, not just HSA-qualified plans;
- Encouraging health insurance portability through individual ownership, a defined-contribution system, and establishment of a consumer-based "health exchange" marketplace; and
- Transforming the health care market into a more consumer-based system in which individuals are empowered to take direct control of their health care decisions.

Establishing Tax Equity in Health Care

The current tax code provides various tax breaks for health care. In 2004, these tax benefits (federal and state) totaled an estimated $209.9 billion, of which $188.5 billion was federal.[3] Over half ($101 billion) of the federal share benefited individuals who obtained their health insurance at their places of work.[4] (See Chart 1.)

The employer tax exclusion allows workers to exclude from their taxable income the total value of health care benefits provided by their employer. However, this benefit is limited to those who obtain coverage through their places of work. Individuals who purchase coverage outside the workplace must use after-tax dollars.

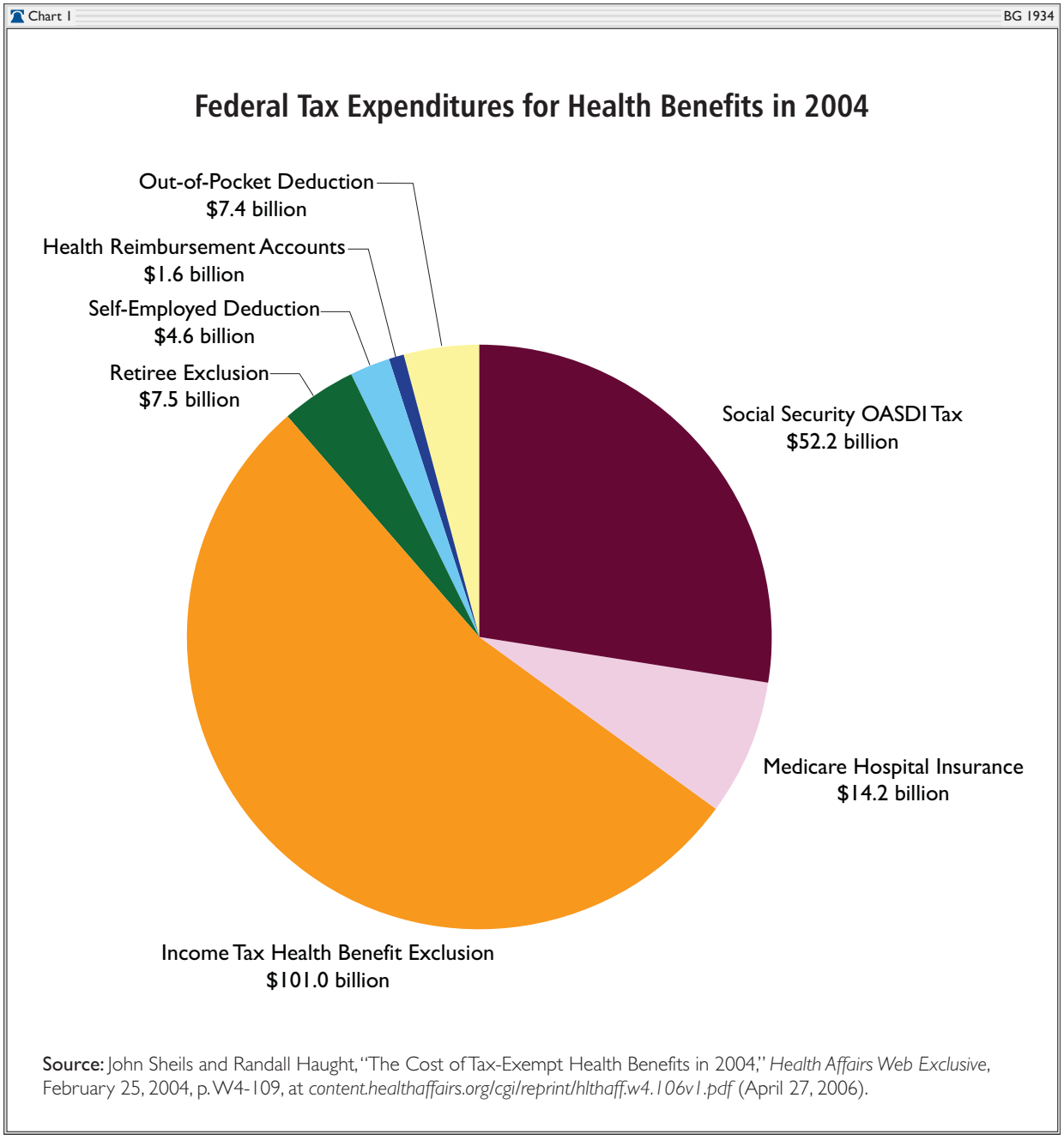
The President's Proposal. The President proposes giving a tax break to individuals who purchase an HSA-qualified high-deductible health plan (HDHP) outside their places of work. An HSA allows individuals to set aside funds in a tax-preferred savings account if they purchase an HDHP. Under the President's plan, individuals purchasing an HSA-qualified HDHP could take an "above the line" deduction for the HDHP premium. These individuals would also qualify for a refundable tax credit worth up to 15.3 percent to offset payroll taxes paid.

For lower-income individuals, for whom a tax deduction is not as valuable because of their limited tax liability, a refundable tax credit would be available to assist them in purchasing an HSA-qualified HDHP. Individuals with incomes up to $15,000 could receive a tax credit worth 90 percent of their HDHP premium with a maximum credit of $1,000. Families with incomes up to $25,000 could receive a similar 90 percent credit with a maximum credit of $3,000. These credits would phase down by income and end at $30,000 for individuals and $60,000 for a family.[5]

What Congress Should Do. The President's effort to provide similar tax relief to those who purchase coverage on their own is a worthy goal, but limiting such tax relief to HSA-qualified HDHPs perpetuates the manipulation of the tax code for certain health insurance arrangements, limits individual choice, and is incompatible with overall tax simplification.

Instead of adding to the already complex patchwork of health care tax subsidies, Congress could accomplish true tax equity by adopting a simple system of universal tax credits—an approach long recommended by The Heritage Foundation.[6]

1. National Economic Council, "Reforming Health Care for the 21st Century," February 2006, at *www.whitehouse.gov/stateoftheunion/2006/healthcare/healthcare_booklet.pdf* (April 27, 2006).
2. For a description and analysis of the 2004 Bush health policy proposals, see Robert E. Moffit, Ph.D., and Nina Owcharenko, "An Examination of the Bush Health Care Agenda," Heritage Foundation *Backgrounder* No. 1804, October 12, 2004, at *www.heritage.org/Research/HealthCare/bg1804.cfm*.
3. John Sheils and Randall Haught, "The Cost of Tax-Exempt Health Benefits in 2004," *Health Affairs Web Exclusive*, February 25, 2004, p. W4-108, at *content.healthaffairs.org/cgi/reprint/hlthaff.w4.106v1.pdf* (April 27, 2006).
4. The remaining $87.5 billion of the federal share went to various other health-related tax provisions including Medicare and Social Security taxes, tax exclusion of retiree benefits, self-employed tax deduction, tax-preferred health reimbursement accounts, and the deduction for out-for-pocket expenses. See *ibid,* p. W4-109.
5. For a detailed description of these tax credit provisions, see U.S. Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals," February 2006, pp. 25–26, at *www.treas.gov/offices/tax-policy/library/bluebk06.pdf* (April 27, 2006).



Under such an approach, health care tax credits would replace the existing system of federal and state tax preferences. However, given budgetary constraints and a limited political appetite for broad health reform, Congress could design a health care tax credit in a variety of other ways besides a universal credit, such as targeting a tax credit to a certain group or population.[7]

6. See Stuart M. Butler, Ph.D., "Reforming the Tax Treatment of Health Care to Achieve Universal Coverage," in Economic and Social Research Institute, *Covering America: Real Remedies for the Uninsured*, Vol. 1, June 2001, at *www.esresearch.org/RWJ11PDF/butler.pdf* (April 27, 2006).

Congress should start by building on the President's tax credit proposal for lower-income Americans. Specifically, Congress should enact a meaningful health care tax credit similar to the President's plan but *without* restrictions on the type of coverage. In fact, offering health care tax credits without coverage restriction is a long-standing position of the Bush Administration.[8]

To avoid limiting the tax credit to HSA-qualified HDHPs, Congress should set a maximum dollar amount for the tax credit and allow the individual to apply the credit to the premium of a health plan of choice. An individual who chooses to spend above the allocated tax credit would be responsible for paying the difference. If an individual spent less (e.g., by purchasing a high-deductible, low-premium option), any remaining tax credit funds could be used for other related health care costs, such as co-pays and deductibles. This approach would allow individuals the freedom to choose the plan design that best suits their needs, encourage prudent plan selection, and—most important—promote tax equity and neutrality.

Promoting Health Insurance Portability

The lack of health insurance portability is a major problem with the employer-based coverage that dominates the private sector. Today's workforce is far more mobile and transient than it was 50 years ago, when a worker would take a job at 18 years of age and stay with that same employer until retirement.

Today, each job change typically means a change in health insurance coverage. Furthermore, individuals who are laid off, leave the workforce for a period of time, or retire early face the same problems. A break or change in coverage, whether voluntary or involuntary, can result in severed ties with trusted providers, episodes without insurance, and an overall disruption in the continuity of care.

The President's Proposal. The President proposes the development of portable HSA-qualified HDHPs to complement the HSA component, which is a portable, individually owned account. Under this concept, national high-deductible plans would be available for employers to offer their workers, and workers could take their health policies with them when they leave their jobs. After leaving an employer, an individual could pay the premiums on a pre-tax basis, and any new employer could also contribute to such a plan on a tax-free basis.

What Congress Should Do. The President is right to encourage portability, but establishing portability for only one type of insurance product—HSA-qualified HDHPs—and depending on employers to offer it compromises the principle of personal choice and freedom. The government should not be in the business of picking winners and losers or stacking the deck in favor of one type of health insurance over another.

The best way to achieve true portability is to enable individuals to purchase and own their health care coverage. In conjunction with enacting an individual health care tax credit, Congress should also facilitate a defined-contribution option for employers and encourage the adoption of a health exchange—a consumer-based marketplace for purchasing health care coverage.

Defined-Contribution Model. Congress should focus on creating an alternative to the existing employer-based system. In today's all-or-nothing system, an employer either offers coverage or does not offer coverage. Congress should help employers who want to make the transition to a defined-contribution model by allowing them to provide a financial contribution to an employee's individual health plan without subjecting the plan to new rules or jeopardizing the existing tax treatment.

The President has proposed using the HSA-model to achieve a similar goal. However, the proposal is limited and contingent on an individual's having an HSA and a qualified HDHP. Congress should pursue an approach that is simpler and broader in its application by clarifying existing laws

7. See Nina Owcharenko, "Health Care Tax Credits: Designing an Alternative to Employer-Based Coverage," Heritage Foundation *Backgrounder* No. 1895, November 8, 2005, at *www.heritage.org/Research/HealthCare/bg1895.cfm*.
8. Moffit and Owcharenko, "An Examination of the Bush Health Care Agenda," pp. 6–8.

so that employer contributions to an employee's individual health plan do not subject that plan to the rules and regulations for group plans. Congress should also clarify that such contributions retain their tax preference to the worker.

Changing to a defined-contribution model would benefit both employers and workers. Employers would be able to establish a more predictable budget for health care, and those that cannot afford to provide coverage under the current system might choose to provide modest contributions to their workers' individual health care plans. Under a defined-contribution system, workers would no longer be limited to the plans offered through their employers. Instead, they would be free to choose the health plans that best meet their needs and the needs of their families. Finally, workers who are excluded in current system, such as part-time and contract workers, could benefit from receiving contributions from multiple employers.

Health Exchange Model. Congress should also encourage the development of a simpler, more consumer-based marketplace for purchasing private health coverage. Health insurance is predominately regulated at the state level, where distinctions are made between the small-group and non-group market. These distinctions can complicate and segment the marketplace.

On the other hand, in a health exchange, these distinctions would be eliminated and replaced with a central market in which individuals, employers, and the self-employer could buy personal, portable, tax-advantaged health care coverage. Individuals would choose from a menu of competing insurers for their coverage. This approach also has the benefit of preserving the favorable tax treatment by allowing an employer to designate the health exchange as its "group" health plan, but federal clarification from Congress still would be useful.

Variations on this concept have been considered at the state level, including the small-business health insurance market reform provisions recently enacted in Massachusetts.[9] Congress could also consider establishing a demonstration project to encourage other states to test variations on the idea.

Expanding Health Coverage Options

Affordability of coverage varies greatly among the states. Some states have overregulated the insurance market, making it unaffordable and unattractive for small businesses or individuals to purchase health care coverage. Policies such as the combination of strict community rating and guaranteed issue price many individuals and businesses out of the health insurance market. In New Jersey, which has both strict community rating and guaranteed issue, premiums for individual coverage cost an average of $6,048 per year, and premiums for family coverage cost an average of $14,403.[10]

Costly coverage mandates can also affect affordability. Today, there are over 1,843 state mandates.[11] Minnesota and Maryland top the list with 60 or more mandates each.[12] In Maryland, even costly but optional procedures, such as in vitro fertilization, are a mandated benefit.[13]

The President's Proposal. The President proposes a multi-pronged strategy at both the state and

9. See Joint Caucus, Massachusetts House of Representatives, "Health Care Reform Conference Committee Bill," April 3, 2006, at *www.mass.gov/legis/presentation.pdf* (April 27, 2006). In Maryland, State Senator E. J. Pipkin introduced the Consumer Health Open Insurance Coverage Act of 2006 (Maryland Senate Bill 530) in 2006. In the District of Columbia, Council members Sharon Ambrose and David Catania introduced the District of Columbia Equal Access to Health Insurance Amendment Act of 2004 (B15-0985).
10. America's Health Insurance Plans, Center for Policy and Research, "Individual Health Insurance: A Comprehensive Survey of Affordability, Access, and Benefits," August 2005, p. 2, at *www.ahipresearch.org/pdfs/Individual_Insurance_Survey_Report8-26-2005.pdf* (April 27, 2006).
11. Council for Affordable Health Insurance, "Health Insurance Mandates in the States, 2006," March 2006, at *www.cahi.org/cahi_contents/resources/pdf/MandatePub2006.pdf* (April 27, 2006).
12. *Ibid.*
13. *Ibid.*

federal levels to ease the troubles facing small businesses and individuals. The proposals intend to expand health care coverage options for small businesses and individuals through three specific policy initiatives:

- Allowing small businesses to pool together nationally to offer coverage to their workers through association health plans (AHPs). These plans would be regulated at the federal level and would hope to gain advantages of scale similar to those of large, federally regulated employer plans.
- Applying the small-business AHP concept to individuals by allowing associations, such as civic and religious organizations, to offer coverage to their individual members on a national level.
- Allowing individuals to purchase health care coverage from other states. This would give individuals—especially individuals in highly regulated states where there are few affordable options—more coverage choices.

What Congress Should Do. The AHP concept would create new coverage options for associations offering health care coverage to their members by replacing costly state regulations with a federal regulatory structure. These arrangements have traditionally been offered as a solution for small businesses.[14] However, as the President rightly recognizes, the AHP concept should also apply to individuals, and efforts to extend new federal pooling arrangements for health insurance should apply to both business-oriented associations and individual-oriented associations, such as churches and civic organizations.

There are valid concerns with expanding the federal role in health insurance, in particular the creation of a new federal pooling arrangement solely for the small-business sector.[15] If Congress intends to pursue this approach, however, the broader application of AHPs to individual associations, as proposed by the President, must be adopted. These individually based groups are compatible with a health care system that is based on personal choice, true portability, and individual ownership—all of which are lacking in today's employer-based system.

A better approach would be for Congress to expand individual coverage options and promote competitive state health insurance markets by permitting the purchase of health care coverage across state lines. Under the President's proposal, individuals would no longer be limited to the coverage options offered within their states; instead, they could purchase a health care policy from another state where coverage might be more affordable. Representative John Shadegg (R–AZ) has developed the Health Care Choice Act (H.R. 2355) based on this concept, and companion legislation (S. 1015) has been introduced by Senator Jim DeMint (R–SC) in the Senate.

The benefit of such an approach is that it protects the prerogative of the states to regulate health insurance while also giving individuals more coverage choices. Moreover, it would spur competition among the states to design a competitive and consumer-friendly marketplace for the purchase of health insurance and would promote a national health care market.

Improving Health Savings Accounts

The enactment of health savings accounts was an important step toward providing individuals with more health care choices. Instead of the traditional high-premium, low-deductible plans, HSAs allow those who purchase a low-premium, high-deductible plan to set aside tax-preferred funds to pay for their health care expenses.[16] The Association of

14. See Small Business Health Fairness Act (H.R. 525 and S. 406). H.R. 525 was passed by the House of Representatives on July 26, 2005, and S. 406 was introduced and referred to the Senate Committee on Health, Education, Labor, and Pensions.
15. Nina Owcharenko, Edmund Haislmaier, and Robert E. Moffit, Ph.D., "Competition and Federalism: The Right Remedy for Excessive Health Insurance Regulation," Heritage Foundation *WebMemo* No. 1060, May 5, 2006, at *www.heritage.org/Research/HealthCare/wm1060.cfm*.
16. In 2006, an HSA-qualified HDHP must have a minimum deductible of $1,050 for an individual policy and $2,100 for a family policy. See U.S. Department of the Treasury, "All About HSAs," November 28, 2005, p. 8, at *www.ustreas.gov/offices/public-affairs/hsa/pdf/hsa-basics.pdf* (May 8, 2006).

Health Insurance Plans (AHIP) estimates that since its enactment, over 3.2 million Americans have enrolled in HSA–HDHP plans.[17]

The President's Proposal. The President has proposed several technical improvements to existing HSAs:

- Increasing the maximum amount that can be contributed to an HSA to match total out-of-pocket expenses, not just the deductible as under current law;[18]
- Making existing health reimbursement arrangements (HRAs) more compatible with HSAs;[19]
- Allowing employers to make larger contributions to chronically ill workers; and
- Allowing individuals who purchase an HSA-qualified HDHP on their own to use their HSA to pay their premium.

What Congress Should Do. The Administration's proposed changes in HSAs take into consideration the experience of the past three years and work to improve the function and administration of HSAs, and Congress should support these efforts. Specifically, the current HSA law limits the amount that can be contributed to an HSA, based in part on the health plan's deductible.[20] However, once the deductible is met, an individual may still be responsible for other out-of-pocket expenses related to the traditional insurance structure. Thus, the President's proposal to increase the contribution limits to meet total out-of-pocket expenses is an improvement. Senator George Allen (R–VA) has introduced S. 2424 to amend the law to reflect this change.

The President proposes facilitating an HRA–HSA conversion that would enable employers to transfer HRA balances to an employee's HSA without penalty. Under current law, an individual cannot have both an HSA and an HRA, except in limited instances. If an HRA is suspended, an individual can have an HSA, but the balance in the HRA cannot be transferred to the HSA. The President's proposal would allow a one-time transfer of HRA balances into HSAs.

The President also wants to allow greater flexibility in allocating contributions to workers, specifically those with chronic illnesses. Under the President's proposal, employers could contribute more to workers who face greater health care costs without violating comparability rules. Congress may want to consider allowing employers to contribute more to their lower-wage workers as well.

Finally, the President's proposal to allow individuals who purchase their own HDHPs to use their HSAs to pay their premiums is also a good idea. Senators John Ensign (R–NV) and Mike DeWine (R–OH) have introduced the Affordability in the Individual Market Act (S. 2554) to facilitate this change.

Ideally, Congress should eliminate the HDHP requirement for HSAs altogether and simply allow individuals to use their HSAs as a savings mechanism for overall health care expenses, such as premiums, deductibles, and other cost-sharing requirements. Under such a change, the free-standing HSA could be a conduit for employer contributions as well as for other subsidies, such as tax credits for lower-income individuals.[21] National Center for Policy Analysis President John Goodman, a health

17. America's Health Insurance Plans, Center for Policy and Research, "January 2006 Census Shows 3.2 Million People Covered by HSA Plans," March 3, 2006, at *www.ahipresearch.org/pdfs/HSAHDHPReportJanuary2006.pdf* (April 27, 2006).
18. The proposal would also provide a refundable tax credit of up to 15.3 percent to individuals who make post-tax contributions to offset the taxes paid.
19. An HRA is another employer-offered tax-preferred health care arrangement in which an employer sets aside funds for an employee for the sole purpose of medical expenses and the balances can be carried over from year to year. For more information, see U.S. Department of the Treasury, Office of Public Affairs, "Treasury and IRS Guidance on Health Reimbursement," June 26, 2002, at *www.treasury.gov/press/releases/po3204.htm* (May 8, 2006), and Council for Affordable Health Insurance, "HSAs, HRAs or FSAs: Which Consumer-Driven Health Care Option Should You Choose?" *Issues & Answers* No. 124, March 2004, at *www.cahi.org/cahi_contents/resources/pdf/n124HSAFSAHRA.pdf* (May 8, 2006).
20. In 2006, the maximum HSA contribution is the lesser of the plan deductible or the maximum amount set by law. The statutory maximum in 2006 is $2,700 for an individual and $5,450 for a family. See U.S. Department of the Treasury, "All About HSAs," p. 16.

care economist and leading expert on HSAs and health care reform, has recommended a more flexible HSA model.[22] Besides encouraging individuals to save for their health care expenses, a flexible HSA design would enable individuals to select a health plan of choice, whether high-deductible or low-deductible, and use remaining balances from their HSAs for other health care expenses.

Advancing Information Access, Prevention, and Better Liability Laws

Efforts to improve consumer information and engagement in the delivery of health care are also desirable goals, but legislation to achieve them should not add new layers of complex and cumbersome federal rules and regulations to the health care system. These would undercut efficiency and expand federal control of a dynamic sector of the American economy.

The President's Proposal. The President stresses continuing efforts on health information technology, improving access to price and quality information, enacting medical liability reform, and promoting health prevention, wellness, and fitness. These are well-intentioned initiatives that focus on ancillary issues affecting the health care sector.

What Congress Should Do. Congress should exercise extreme caution before recommending federal legislative solutions in these areas. For example, medical liability has traditionally been a state issue under state jurisdiction, and many states have already taken positive steps in reforming their state medical liability laws. Federal efforts should work to encourage more states to review and reform their medical liability laws. Various policy options are available to state lawmakers.[23]

It would be best for Congress to focus on reorganizing the health care market and transforming it into a more consumer-based system in which individuals are empowered to act on quality and price information, to maintain their personal medical records, and to take direct control of their health care decisions. Such a transformation would go a long way toward improving the functioning and performance of health care institutions. The more consumers are in control, the more receptive the insurers and providers will be in meeting their demands, and the more incentives consumers will have to practice and live a healthy lifestyle.

Conclusion

The core elements of the President's health care agenda are sound: providing tax equity, promoting portability, improving HSAs, and expanding coverage options.

Members of Congress should build on these elements and enact solid policy initiatives that reflect a health care system that is based on personal choice and free-market competition. The cornerstone of this system should be a robust individual tax credit that would give individuals the freedom to choose the health plan and design that best suits their personal needs and preferences.

The President has outlined a laudable vision for health care policy that is based on expanding personal ownership of insurance and individual control of health care dollars. Congress should take this opportunity to enact health policies that will transform that vision into reality.

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21. If such a change is adopted, the tax treatment of HSAs could also be amended to make it similar to the tax treatment of IRAs and 401(k) plans.
22. John C. Goodman, "Making HSAs Better," National Center for Policy Analysis *Brief Analysis* No. 518, June 30, 2005, at *www.ncpa.org/pub/ba/ba518* (April 27, 2006). For another variation of this approach, see Michael F. Cannon, "Combining Tax Reform and Health Reform with Large HSAs," Cato Institute *Tax and Budget Bulletin* No. 23, May 2005, at *www.cato.org/pubs/tbb/tbb-0505-23.pdf* (April 27, 2006).
23. See Randolph W. Pate and Derek Hunter, "Code Blue: The Case for Serious State Medical Liability Reform," Heritage Foundation *Backgrounder* No. 1908, January 17, 2006, at *www.heritage.org/Research/HealthCare/bg1908.cfm*.