Forbes

Avik Roy
4/30/2012 @ 12:30PM

How George W. Bush Would Have Replaced Obamacare

In January of 2007, George W. Bush was entering the final stretch of his two-term presidency. Bush, however, chose not to ride off simply into the sunset. Instead, he put forth a comprehensive plan to reform the private health insurance market. It's long-forgotten now, because Democrats had just regained control of Congress, and these newly-empowered legislators pronounced the Bush plan "dead on arrival." In many ways, though, the Bush proposal was impressive and credible. It would have expanded coverage while reducing the deficit. Should it serve as the starting point for replacing Obamacare?

Today, when it comes to health care and entitlements, Bush is best-known for his 2003 Medicare prescription-drug benefit. That plan is widely unloved; conservatives complain that it permanently increased the deficit, while liberals dislike its market-oriented features. But had Bush's 2007 plan made it into law, it would have unleashed a market-driven revolution in private health insurance, one that would have made insurance cheaper for the people who need it most. Obamacare, as we know it today, would not have been drafted.

The Bush plan was formulated by the White House's National Economic Council, under the leadership of Allan B. Hubbard. The core goal of the plan was to equalize the tax treatment of employer-sponsored and individually-purchased health insurance, without increasing the deficit. (As regular readers know, the fact that employers can purchase health insurance for their workers tax-free, whereas individuals can't, is the original sin of the U.S. health-care system.)

Equalizing the tax treatment of individually-purchased health insurance
Bush's proposal sought to eliminate the unlimited tax break for employer-sponsored insurance, replacing it with a standard deduction for everyone. Under the plan, anyone—employed or not—who bought at least catastrophic insurance would not pay income or payroll taxes on the first $7,500 of their income, or the first $15,000 for a family plan.
It's an idea with a long history in Republican policy circles. In the early 1980s, President Reagan proposed capping the employer-sponsored insurance deduction, in order to reduce the deficit, but it went nowhere in Congress, because Republicans

saw it as a tax increase, and labor unions saw it as a threat to their generous benefit packages. In 1992, George H.W. Bush also sought to cap the exclusion and use the savings to fund tax-credit subsidies for the uninsured, but the elder Bush had recently violated his "no new taxes" pledge, and House Republicans were in no mood to raise taxes again.

The Bush plan's numbers were designed with 2009 insurance prices in mind, and the tax-deduction thresholds would grow with CPI inflation. The Treasury Department estimated that the plan would lower taxes for 80 percent of those with employer-sponsored insurance, and increase taxes for the remaining 20 percent. It would have especially benefited the 18 million people who then bought insurance on their own, along with many of the uninsured, who would suddenly find health insurance to be significantly less expensive.

As Julie Goon and Kate Baicker explained in a related press briefing, people would get the entire $7,500 or $15,000 deduction even if their insurance plans were cheaper than those thresholds. That way, they would still have the incentive to shop for value, instead of simply buying a plan that met the $7,500/$15,000 level. Obamacare contains something akin to a cap on the employer tax exclusion in its "Cadillac tax," which imposes a 40 percent excise tax, beginning in 2018, on plans costing more than $10,200 for individuals or $27,500 for families. This tax is adjusted for inflation, as the Bush plan was. But its implementation was pushed out to 2018 at the behest of labor unions, which, as I noted above, are among the principal beneficiaries of generous health-insurance packages.

In contrast to Obamacare, however, the Bush plan would have turbocharged the market for consumer-driven health plans, tied to health savings accounts, because the most economically efficient use of the deduction would be to purchase a sufficiently generous consumer-driven plan that allowed individuals to put a maximal amount of money into HSAs. Obamacaresignificantly constrains the use of HSAs in its regulated insurance markets.

Expanding coverage by redirecting federal health dollars

President Bush also proposed an "Affordable Choices Initiative," which would redirect existing federal spending in states that sought to expand coverage to the uninsured.

As you'll remember, the 1986 EMTALA law forces hospital emergency rooms to care for anyone who shows up, regardless of their ability to pay. In order to partially compensate for this mandate, and underpayments from Medicaid and Medicare, the federal government gives most urban hospitals "disproportionate share hospital," or DSH, payments. Bush proposed to shift these dollars away from hospitals and toward uninsured individuals directly.

States would design their own programs for expanding coverage, subject to approval by the HHS secretary, such as offering direct subsidies for insurance premiums,

expanding or creating high-risk pools, or setting up Massachusetts-style exchanges. "Rather than perpetually pay the bills of uninsured people," said then-HHS Secretary Mike Leavitt, "it's better to use part of the money to help them get a basic insurance policy. They get better care and the money ultimately goes further."

Congressional Democrats dismissed the plan as "dead on arrival"

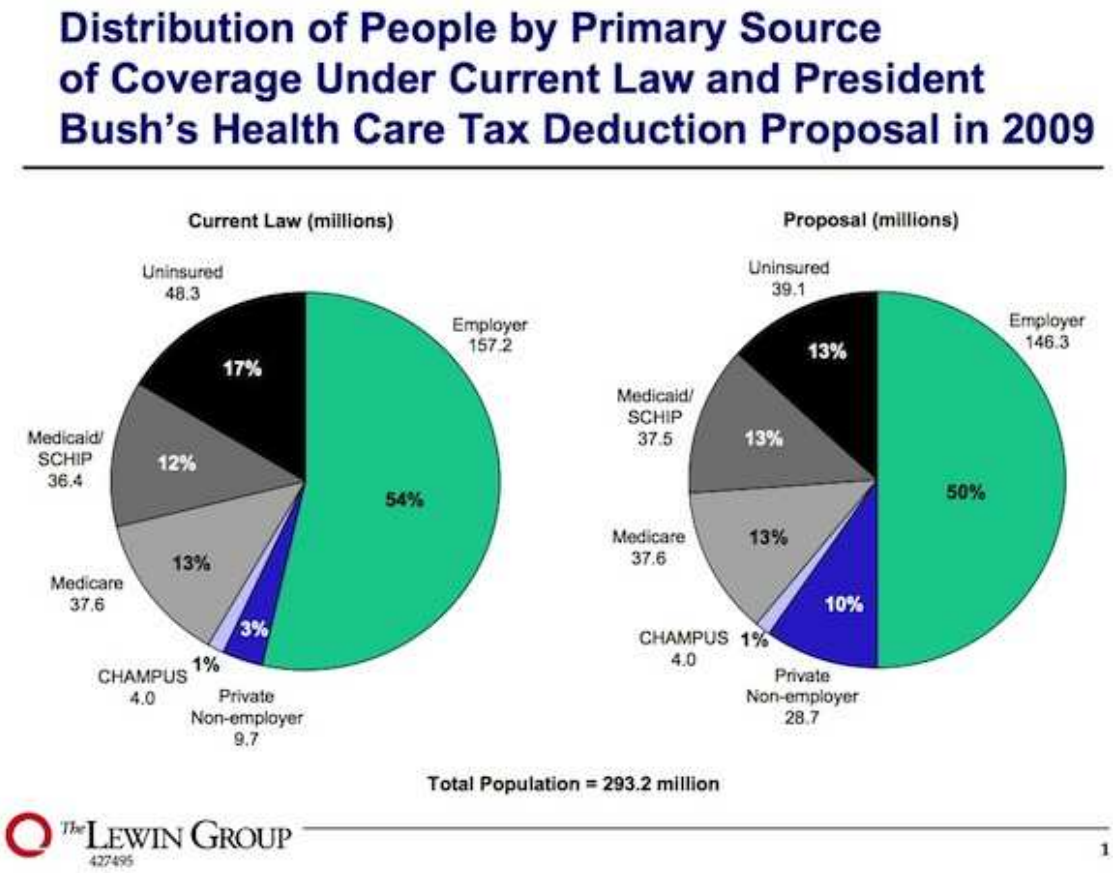
This was no throwaway proposal. President Bush devoted 448 words to it in his 2007 State of the Union Address: 8 percent of the total. (President Obama's much-longer 2012 speech, by contrast, contained around 50 words about health care.) The Urban Institute called it "innovative" and a "major step." Bush achieved the remarkable trifecta of being praised by the editorial board of the liberal *Washington Post*, the center-right *Economist*, andMichael Cannon of the libertarian Cato Institute. I would have said hell would have frozen over first.

Unfortunately, Bush's plan went nowhere in Congress. Democrats had zero partisan incentive to cooperate with Bush, given the possibility that a Democratic President would be elected in 2008. Rep. Pete Stark (D., Calif.), then chairman of the key Health Subcommittee of the House Ways and Means Committee, pronounced it "dead on arrival."

Sen. Ted Kennedy (D., Mass.), in a bizarrely dishonest attack, said, "I find the plan troubling because it does nothing to help people get insurance, hurts those who already have it and provides a tax break that benefits the wealthiest Americans." (The plan would have expanded coverage, and eliminated a major source of regressivity in the tax code.)

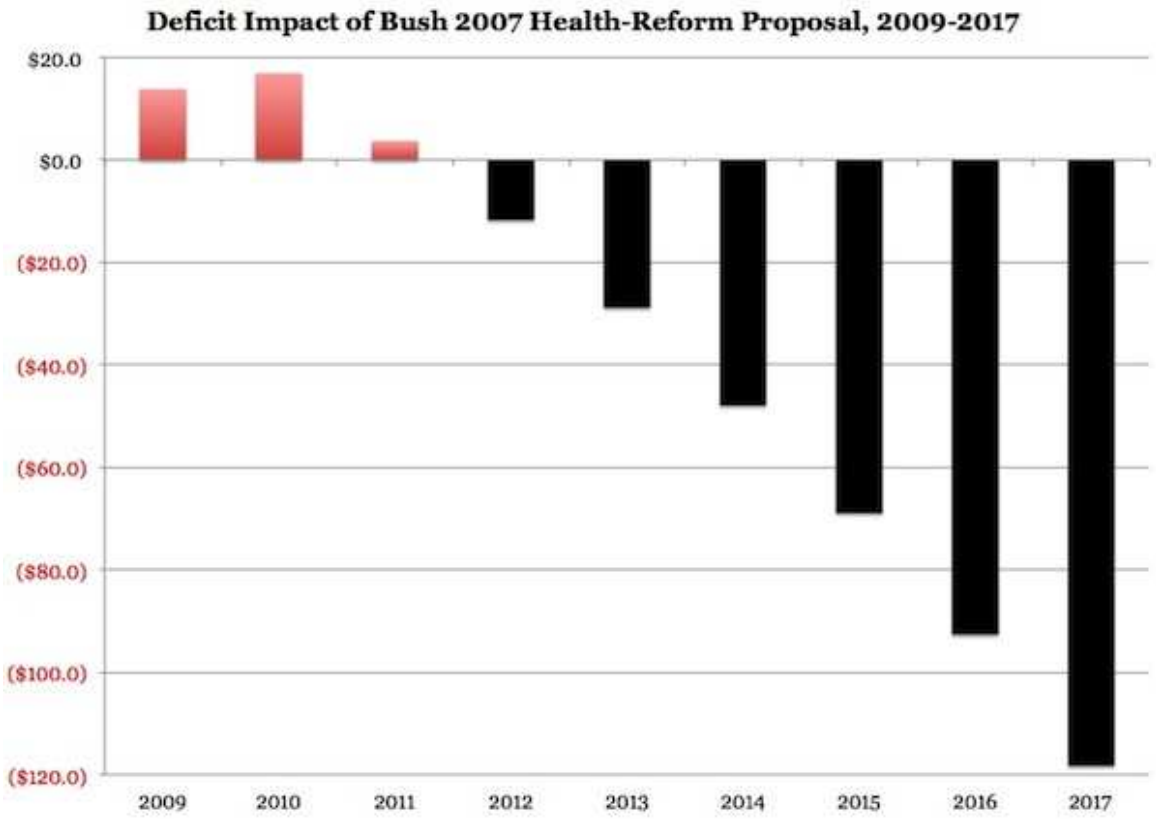
The Bush plan would have expanded coverage and reduced the deficit

The Lewin Group analyzed the Bush tax reform using its Health Benefits Simulation Model, and estimated that equalizing the tax treatment of health insurance would expand coverage by 9.2 million people. In addition, the Bush administration estimated that the Affordable Choices Initiative would expand coverage by an additional 2 million or so, for a total of about 11 million. That's not as large a coverage expansion of Obamacare, at 33 million, but that 11 million is achieved with zero increase in federal spending commitments: a pretty impressive bang for the buck.



In addition, Obamacare's 30-million coverage expansion figure may be substantially inflated. If the individual mandate gets struck down by the Supreme Court, the Congressional Budget Office projects that the law would expand coverage by only about 17 million, despite trillions of additional federal spending.

Even more impressively, the Joint Committee on Taxation—the government agency responsible for the CBO's estimates of the impact of tax legislation—projected that the Bush proposal would reduce the deficit by $334 billion from 2008 to 2017, and by trillions more in later decades, because the tax deduction would grow at the rate of inflation, whereas the tax exclusion of employer-sponsored health insurance isn't capped by law, and grows along with overall, and higher, health inflation.



These savings could have been used by the Bush administration to reduce the deficit, or alternatively, to create a $5,000 tax credit to for the uninsured to purchase health care, as George H.W. Bush had proposed. "This would be preferable to raising the $15,000 deduction" in the 2007 plan, the *Wall Street Journal* noted, "because the lower the deduction, the greater incentive for judicious consumption of health dollars."

Criticisms of the Bush plan

Though Democrats in Congress shot down the Bush plan for partisan rather than substantive reasons, there are a few critiques of the Bush approach that are worth discussing.

The first is that the Bush plan would not have achieved *universal coverage*, though its coverage expansion would have been quite meaningful. Indeed, the estimates I described above are conservative, because they make no assumptions regarding the ability of competitive pressures to reduce the trajectory of overall health spending. Again, a cap on the tax exclusion paired with a universal tax credit for health care spending, as Paul Ryan has proposed, could achieve universal coverage.

The second criticism is that capping the employer tax exclusion has the *net effect of raising taxes*. Some conservative anti-tax activists oppose reform of the employer tax exclusion on this basis. But those activists fail to appreciate the degree to which the current tax code increases federal health spending, forcing further taxpayer

commitments. Tax-exclusion reform could be combined with a reduction in overall tax rates, or tax expenditures on the uninsured, so as to make any reform plan revenue-neutral. (For what it's worth, Grover Norquist's influential Americans for Tax Reform backed the 2007 Bush plan.)

The third is that the plan would shift more Americans into the *individual market* for health insurance, which is a very good thing over the long-term, but would require some transitional considerations. Today, because of the distortions caused by the employer tax exclusion and other regulations, the individual market for health insurance is quite inefficient. Individual-market health plans are more expensive, for fewer benefits, with more overhead, compared to plans purchased in bulk by employers.

One promising solution to this problem was proposed by Bush's National Economic Council in 2006: allowing trade associations, religious groups, and other civic organizations to pool risk through "association health plans," so that small businesses and people in the individual market could benefit from the same economies of scale that larger businesses do.

A fourth criticism encompasses the *generic left-wing opposition* to market-oriented reforms. These would include: (1) individuals aren't competent to choose their own insurance plans, because plans are too complicated, and that experts should choose on their behalf; (2) comprehensive insurance is better than consumer-driven plans that pair high-deductible insurance with health savings accounts, because individual consumers don't make good health-care choices; and (3) the tax deduction would be indexed to inflation, which will increasingly expose people to rising health costs.

Criticisms (1) and (2) are ideological. You either believe consumers are capable of making choices for themselves through market mechanisms, or you don't. Criticism (3) assumes that market forces won't do anything to retard growth in health expenditures, when in fact there is plenty of reason to believe that people will be much more mindful of their health spending once they are in a position to economically benefit from greater frugality.

Implications for replacing Obamacare

Many conservatives believe that achieving universal coverage is not a worthy goal, for two reasons: first, they fear that universal coverage would require a massive expansion of government; and second, they know that universal coverage is a top priority of the left, and therefore are instinctively suspicious of it.

But universal coverage is hardly incompatible with market-oriented health care. Indeed, Switzerland shows us that a wholly-private, market-based health insurance system can achieve universal coverage while spending far less money than the United States spends today. It would be a tremendous achievement for conservatives to install a market-based system for universal coverage, one that would stabilize our

deficit while solving a genuinely pressing public-policy problem, a problem that today provides unnecessary fodder for socialized solutions.

In sum, then, the Bush plan of 2007 is a worthy foundation for market-based health reform, in that it shows how capping the employer tax exclusion can free up health-care resources for other purposes. But a true plan for replacing Obamcare will use some of those resources to provide tax credits to the uninsured, achieving universal health care.

This may seem like a lot of abstract theorizing. But we are less than two months away from a Supreme Court decision that may throw out Obamacare in its entirety, or dramatically reshape the law's configuration. The time to consider plausible alternatives is now.

Follow Avik on Twitter at @aviksaroy.