Commentary

A 10 Million-Person Exaggeration?

Alan Reynolds, 10.11.09, 4:48 PM ET

In Washington, the word "reform" is used (like the word "stimulus") to mean grandiose federal spending plans. The Congressional Budget Office has emerged as the key arbiter of the latest Congressional plans to increase and redistribute federal spending on medical care. That is unfortunate, because these CBO estimates have been hastily patched together under impossible deadlines and intense political arm-twisting.

The CBO's instant analysis of the latest Senate Finance Committee proposals claims the number of uninsured would fall by 29 million, and implies (with critical caveats) that revenues from slashing Medicare and imposing a 40% tax on Cadillac insurance plans might suffice to pay the bills.

Nearly half the alleged reduction in the number of uninsured (14 million) is attributed to a vast expansion in the number of non-poor people made eligible for Medicaid, at a cost of $80 billion a year by 2019.

But that 14 million figure is exaggerated by at least half, because such "public options" are commonly substituted for private options. As the 2009 Medicare trustees report points out, for example, "many Medicare beneficiaries who had private drug insurance coverage (such as Medigap policies) switched to the subsidized Part D coverage in 2006." The same thing will happen if subsidized Medicaid coverage crowds out private plans.

Investigating a previous expansion of Medicaid in 1987-92, Harvard economist David Cutler and Jonathan Gruber of MIT found that "between 47% and 74% of the increases in Medicaid coverage due to these expansions were offset by lower private insurance coverage."

Using the low end of that 47% to 74% range, suppose only half of the CBO's 14 million new Medicaid beneficiaries would otherwise have been insured privately. That means pulling the other 7 million out of the ranks of the uninsured would cost taxpayers $11,429 per person by 2019--a Cadillac plan with the quality of a Yugo. It also means the net reduction in the number of uninsured would be 22 million, not 29 million. But that 22 million figure is also much too high.

Just as millions would gladly replace insurance they now pay for with Medicaid that someone else pays for, millions would likewise replace their employee contributions to employer-provided plans with subsidized plans on federal exchanges.

Subsidies are much more attractive than tax-exempt perks to the 47% of Americans who don't pay income tax. Yet the CBO estimates that the number of Americans sticking with employer-provided plans will fall by only 3 million after 2015--less than 1.9%. A July 14 CBO analysis of the House plan, by contrast, had the number on employer plans falling by 9 million, and the Lewin Group estimated a larger decline.

If 9 million lose their employer plans, rather than the CBO's rosy new estimate of 3 million, some of those 9 million may well be added to the ranks of the uninsured. Most would probably move into subsidized plans. But that means the number qualifying for subsidies would be several millions larger, so the cost of this proposed entitlement program would be *much* higher than the CBO imagines.

Firms with more than 50 workers would be subject to a fine (tax) if they let their employees grab the subsidies offered in the federal exchange. But many employers are paying more than the fine for health benefits, and premiums would soar if insurance companies are compelled to ignore preexisting conditions and charge similar rates regardless of health risks. Wages might rise if employer health benefits were cut, but that effect would be muted because subsidies to plans bought on the exchange would largely offset the loss of employer contributions.

Even if a greater than estimated exodus from corporate plans to subsidized plans did not add many billions to the CBO's estimated cost of subsidies, the agency would still be mistaken about the plan's supposedly benign effect on budget deficits.

The proposal to slash Medicare payments to physicians by more than a third would cause such trauma for Medicare patients that those cuts are as unlikely to materialize as other cuts Congress previously put down on paper (as a budget trick), then promptly repealed. The CBO said as much but did so too politely for most reporters to get the point.

The revenue predicted from taxing the stuffing out of Cadillac health plans is equally unlikely. It assumes nobody would bother doing anything to avoid paying a 40% penalty tax. According to the CBO, the Joint Committee on Taxation "estimates that the [40% tax] would generate about $46 billion in additional revenues in 2019 and that receipts would grow by roughly 10% to 15% per year in the following decade." The more you tax previously tax-free perks, the faster they grow?

In reality, Congress would be lucky to collect $10 billion a year from this punitive tax, and growth of revenues beyond 2019 would be negligible or negative. If the government slaps a 40% tax on high-premium health plans, affected employees would quickly demand to be compensated in some way that is not so brutally taxed. Substituting more salary for a cheaper health plan would be a win-win deal for all employees who are in a tax bracket lower than 40%.

In short, the CBO estimate of the number of people who would stop being uninsured under the Senate Finance Committee proposal is exaggerated by at least 7 million to 10 million. And any notion that vastly expanding Medicaid and insurance subsidies would not add enormously to future budget deficits is entirely fanciful.

Alan Reynolds is a senior fellow with the Cato Institute.

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