

**Funding Health Care for All Americans**  
**Comments on Fuchs-Shoven and Oberlander**  
**by Alan J. Auerbach, University of California, Berkeley**

These two interesting papers consider the economics and politics of reforming the U.S. health care system so that it provides universal coverage. Before I launch into a discussion of the papers themselves, let me raise one question that neither paper addresses: what is the exact population that such reforms would cover. Clearly, the target population is those currently uninsured; but which uninsured? Citizens, surely; plus permanent residents? plus other legal aliens? plus illegal aliens? We know that there are millions of illegal aliens in the United States, and I assume that a vast majority of this group has little or no insurance covering health care provided in the United States. It is worth thinking about this group when considering universal health care, because systems that depend on individual mandates may be more difficult to apply to those who stay in the shadows. Policies that extend coverage may also be controversial, as we have learned from the recent dispute over whether to issue drivers licenses to illegal aliens. This year's immigration reform debacle in Washington suggests that the issue of how to deal with illegal aliens will not go away soon.

These two papers divide labor according to the authors' comparative advantages, with Fuchs and Shoven focusing on the economics of going to universal coverage, and Oberlander on the politics. But there isn't complete specialization, and that is a good thing. There isn't much point discussing an economically attractive reform that has no chance, politically, and it helps to know the economics of different proposals, particularly the incidence (or at least perceived incidence) of their costs and benefits, to predict how the proposals will fare in the political arena. In my comments, I will start with some fundamental issues that arise with respect to both papers and then move on to more specific comments on the two papers individually.

## **What is Universal Health Care?**

As President Bush has recently reminded us, being without health insurance is not equivalent to being entirely without health care when there is an emergency room available. While this may seem a callous perspective, one can imagine a health care system in which the uninsured have access to health care clinics funded by government and private charities that provide basic care and are better designed to do so than are emergency rooms. That is, universal care need not be achieved through universal insurance coverage. But neither paper considers reforms of this type, looking instead at proposals that provide universal insurance coverage, whether through vouchers or a system of national health insurance. So it is worth asking what might make universal insurance potentially more attractive. One possible argument is that a system set up separately for the uninsured may ultimately face political difficulty maintaining funding. This is basically the same argument made over the years by proponents of a universal social security system against a system of low-income support for the elderly. Also, like social security, universal insurance coverage would involve redistribution from the more fortunate to the less fortunate, with fortune in this instance relating not just to income but also to health.

But there are also economic and political costs to be paid when programs are universal. Programs that raise money from the middle class in order to provide the middle class with benefits can increase deadweight loss; even if the net incidence is small for such groups, the distortions of running the system need not be. And having a large group of beneficiaries, particularly when costs and benefits have a different time pattern over the life cycle, can produce a strong constituency favoring the status quo. I will return to these points below.

## **Why are Economic Analysis and Political Analysis Distinct?**

In a simple world with identical, representative, rational agents, there would be no need to distinguish economics from politics. If one system were more efficient than another, the agents would be unanimous in preferring it. The political process matters once agents vary with respect to health and income, but there is much more going on here than a search for the median voter among the winners and losers from each proposal. At least three types of divergence from rationality (or at least from economists' standard view of rationality) arise when trying to bridge the gap between the economics and the politics of health insurance reform. They are useful to distinguish because they have different implications for policy design.

### ***Misunderstanding of Incidence***

An argument that comes up, especially in Oberlander's paper, is that the current system of employer-provided insurance is particularly attractive (at least to those who have solid coverage) because employees misperceive the incidence of the cost of insurance, not realizing that they bear much or all of the after-tax cost of insurance through lower compensation. Thus, they might favor the current system over one in which they are actually better off, but for which the costs they face are more evident to them. An optimist's response to this faulty information might be that misinformation can be reduced through a concerted effort at education. But, while I think there would be real benefits to our political process from an increase in economic literacy, I also think that there are severe limits to what we can accomplish in this direction.

A more realistic alternative, it seems, is to take advantage of the same misperceptions when designing the potential reform. If employer-based coverage is irrationally attractive, for example, then try to maintain some elements of it when designing the reform, while at the same time eliminating the distortions we associate with the current employer-based system. The

method could be as simple as making employers responsible for paying the premiums of a universal system, much as they now “pay” the employer portion of the OASDHI payroll tax.

### ***Unstable Individual Preferences***

Fuchs and Shoven provide a categorization of those who currently don’t have health insurance. Some are behaving perfectly rationally. For example, those in their “low users” group face a very high price for the actual benefits they would receive; the “free riders” would prefer to get services for free rather than paying for them. But their “gamblers” – people who “prefer to take their chances” – are not necessarily risk-lovers of the standard sort; they may just be people who prefer not to think about getting sick. A strong argument for universal insurance, as in the context of old-age pensions, is that some people don’t know their true preferences, or have preferences that are unstable over time.

Education may have little impact if deep psychological factors are at work. Again, there may be some ways that program design can adapt. To take a page from the recent literature on 401(k) plan participation<sup>1</sup>, one might move more toward universal coverage by forcing people to opt out of coverage, rather than making participation mandatory. But it also may be that we are stuck with some people being unhappy when presented with a reform that ultimately makes them better off. This makes the politics of reform difficult.

### ***Misunderstanding of Costs and Benefits***

A standard criticism of our system of third-party insurance coverage is that it sharply reduces the sensitivity of health care demanders and suppliers to the actual price of medical services. But there is a problem here beyond that of ex post moral hazard. People aren’t just

---

<sup>1</sup> See Madrian and Shea (2001).

insulated from the true price – they don't know what the true price is. Thus, they won't know when facing the true cost of insurance whether it's a good deal or not, and they won't necessarily make the right political decisions about the scale of a taxpayer-funded health care system.

There are things we can do to make costs more salient. Both Fuchs and Shoven and Oberlander discuss why a dedicated, visible tax might help control the costs of a government funded program. Earmarked taxes have their problems as well, notably in reducing the flexibility of the tax structure, but I find the cost-control argument compelling. At the level of individual insurance purchases, it may be that having to choose whether to add options that provide additional elements of coverage may also provide some sense of what things cost (or at least what they cost for the particular risk pool that opts for the coverage).

### **Comments on the Papers**

In addition to these general comments, let me also offer raise some more specific points with respect to the individual papers.

#### ***Fuchs-Shoven***

Fuchs and Shoven make many useful points as they go through their analysis, reminding us that a tax by any other name is a tax and identifying the key elements of achieving universal coverage: compulsory participation, subsidies for the indigent to make participation economically and politically palatable, and grouping to minimize administrative costs and adverse selection. When considering which tax to rely on for dedicated funding, they lean toward consumption taxes over payroll taxes because this would spread the burden more comprehensively over the population, and find little merit in using the corporate income tax for

this purpose. Among consumption taxes, they suggest that a sales tax would be more transparent while a VAT might be easier to administer.

Moving on to consider the economic effects of reform, they use a particular plan with which they are quite familiar – the Emmanuel-Fuchs individual voucher plan – as a vehicle. Focusing on a concrete plan is very helpful when discussing the incidence and efficiency of moving to universal coverage, as is their approach of looking separately at the effects on different population groups, varying by employment status, current insurance coverage, etc. This decomposition helps to distinguish overall effects from effects associated with redistribution or with particular situations, and leads them to a key conclusion:

Our overall impression of the analysis, however, is that the average change in welfare for people in average circumstances would be small. The overriding fact is that most of these people have been obtaining and paying for health insurance and health services all along and the switch from one means of payment to another leaves only second order effects in terms of economic welfare. (p. 32)

That is, these individuals would benefit from elimination of certain idiosyncrasies of the current employer-based system, such as job lock, but otherwise would be paying for insurance, just as they are today. This conclusion rests on two others, that current insurance premiums have roughly the same incidence as would the typical individual's costs under the new system, and that the labor market distortions of the two systems would be similar. These conclusions more or less go together if one accepts their argument that a dedicated tax that pays for insurance, such as a payroll tax, and employer-provided insurance premiums are economically similar. But this argument requires further discussion.

To make the analysis as clear as possible, consider two simple alternatives. Under the first, a representative individual's employer provides health insurance. Under the second, the individual receives the same insurance at the same cost. Fuchs and Shoven argue that these two

circumstances are basically the same from an economic perspective, because the cost of insurance in the first case will be borne by the worker in the form of lower wages; thus, wages will be lower by the same amount, whether reduced by the payroll tax or by the shifted cost of employer-provided benefits.

If individuals are assumed to work, and if hours of work are fixed, then I agree with this analysis. But if either of these conditions does not hold, then I think the economic outcomes will be different in the two cases. Consider first the hours-of-work decision, conditional on working. Under the payroll tax, the individual faces a reduced after-tax wage at the margin, relative to the case of no insurance, because there is no additional coverage achieved by working more. In the employer-provision case, the full tax wedge may not be present. For example, if the hours-of-work decision involves shifting among jobs, the hourly wages of these jobs can adjust to the cover the cost of insurance coverage, averaged over the number of hours of work. Thus, there may be a smaller wedge in the employer-provision case between the marginal product of labor and the worker's net wage.

Next, consider the decision whether to work, which may be a relevant margin of decision even for individuals who end up working, in equilibrium. If the individual gets no free insurance coverage if not working, then insurance constitutes a benefit of working. Indeed, this is one of the arguments for why the incidence of employer-provided benefits, even possibly if mandated, falls on employees.<sup>2</sup> But if payroll-tax financed insurance is provided whether an individual works or not, then there is no marginal benefit associated with working, just the tax, so the decision of whether to work will be distorted, and only part of the burden borne by workers if there is a labor supply response that raises wages.

---

<sup>2</sup> See Gruber (1994).

For some workers, neither the intensive nor the extensive labor supply response may be very significant. For them, the Fuchs-Shoven analogy works well. But for other individuals the analogy breaks down, and it is an empirical question how important the added distortions are.

### *Oberlander*

I come to a paper about the politics of universal health insurance as more of an outsider, and as an outsider I have questions that may reflect reactions to differences in style of exposition rather than to substance. With that caution, let me raise at least one economist's quibbles with some of the points made in this paper, which I found on the whole to be very helpful in thinking about the political environment in which health reform must take place.

First, what are the fundamentals of the political process? The paper devotes most of its space going through a "financing menu" for paying for universal health care. Some options look politically better than others, but which of the political strengths and weaknesses are inevitable, and which depend on the identity of the chef du jour. Oberlander notes in his conclusions that much depends on who rules Congress and the White House; but much doesn't, and it would be helpful to distinguish between the two categories throughout the paper.

For example, the paper argues that building on employer provision has its advantages, including the fact that employees who have adequate coverage would see less of a disruption in their situation. But this conclusion must depend on how happy people are with the current system of employer provision. If it gets unattractive enough, a break from the past may represent an advantage. On the other hand, individuals can generally be expected to look less favorably on a system that shifts more of the burden to them from others, all other things being equal. Self interest exists regardless of who is in the White House.

I also had trouble following some of the paper's particular arguments. For example, there is an argument (p. 11) that individuals won't be particularly sympathetic to capping the employer exclusion for health care benefits because such a reform is aimed at reining in coverage that "is likely not an insurance policy that many Americans would recognize as their own." (p. 11). But if the cap is only aimed at the top of the distribution, then why should most people care? Are they worried about the camel's nose, are they simply misinformed, or are particular lobbying groups especially effective on this issue?

Why does the fact that the "U.S. raises fewer revenues than other industrialized democracies" complicate "efforts to adopt and pay for public programs"? (p. 4) If two countries differed only with respect to whether health care was provided by government or by the private sector, the country with private provision would raise less revenue and this would tell us nothing about the feasibility of a switch to government provision. More generally, lower revenues as a share of GDP could mean greater fiscal capacity, or could reflect more anti-government sentiment, but the tax-GDP ratio doesn't reveal any information about these two possibilities.

I had some difficulty telling whether Oberlander views effective cost control as a political benefit or as a cost. Like Fuchs and Shoven, he observes that an earmarked tax, like a VAT, could promote cost control. (p. 23) But he also suggests (on pp. 6-7) that "the return of PAYGO makes it harder to finance universal coverage" because it means that people are more likely to see what universal coverage really costs. Perhaps the point here is that tying funding to universal coverage makes universal coverage less popular but more effective, perhaps simply an important illustration of the misunderstandings I discussed above.

## **Conclusions**

Together, these two papers provide an informative perspective and leave one with some grounds for optimism and plenty of reasons to be pessimistic. The optimism stems from the fact that universal coverage is feasible. The Emmanuel-Fuchs plan is not the only game in town, but one is more than zero. On the other hand, there are countless political reasons why we can't enact that plan or any other plan to provide universal coverage. A very serious problem is that while there might be overall gains in social welfare from adopting universal coverage, not everyone or even a vast majority of the existing population would be winners, especially in the short run, before significant efficiency gains can be realized. Making them understand better the consequences of a move to universal coverage could well make them less favorable toward the reform.

## **References**

Gruber, Jonathan, 1994, "The Incidence of Mandated Maternity Benefits," *American Economic Review* 84(3), June, pp. 622-641.

Madrian, Brigitte C., and Dennis Shea, 2001, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics* 116(4), November, pp. 1149-1187.