



**Tax Policy Center**  
Urban Institute and Brookings Institution

## **Different way to pay for health reform**

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Expanding health-care access is a top priority for the Obama administration, and leaders in Congress are on board. The stakes are high; the Democrats remember only too well how the Clinton health-care debacle cost their party control of Congress, and they don't want to repeat the experience.

To their credit, political leaders also agree that any health insurance expansion must not increase the deficit. Given the \$9 trillion of projected deficits over the next decade, more red ink is not what the doctor ordered.

The trick, of course, is how to pay for it. President Obama's campaign proposal would cost something like \$1.5 trillion over 10 years. There are no painless options for raising that kind of money.

The president proposed covering a fraction of the cost by limiting deductions for high-income taxpayers. But that immediately drew fire from nonprofit groups (charitable deduction) and real-estate agents (mortgage interest). Others have proposed limiting tax breaks for employer-sponsored health insurance, but as a candidate, Mr. Obama skewered Republican John McCain for proposing to eliminate the popular tax break. Republicans would have a field day slinging that bit of campaign rhetoric back in the president's face.

And so it goes. Because new taxes and real program cuts are politically perilous, I worry that policymakers will simply assume the problem away - implement market reforms intended to cut waste and inefficiency and then instruct a skeptical Congressional Budget Office to take it on faith that the reforms will be fabulously successful. Alternatively, they might design some bogus trigger mechanism: "If we don't achieve the desired cost savings, we'll make really hard decisions then. Honest."

That trigger will never be pulled, and the deficit hole will be that much deeper.

To be sure, we must slow the growth of health-care costs. But an aging population, the cost of covering the uninsured and the fact that many medical advances really are worth paying for guarantee that health-care spending will go up over time.

So how do we pay for health care without sinking the economy? The best option would be to phase in a value-added tax (VAT) dedicated to paying for health care.

A VAT, which nearly every country has, is basically a sales tax on all goods and services that is collected in stages from all the producers in the supply chain. A 10 percent VAT would add 10 percent to the price of all goods and services.

It might sound nuts to add a tax during a recession, but announcing a future VAT could help revive the economy. Suppose the administration announced that a 5 percent VAT would take effect in 2010 and rise to 10 percent in 2011. That would boost spending - and the economy - now and again in 2010, as people accelerate purchases, especially of such big-ticket items as cars and major appliances, to avoid the future tax increase.

The VAT would also provide long-term economic benefits by encouraging people to save, because it taxes spending but not saving.

The conventional wisdom is that a VAT would be political suicide. But a VAT earmarked to pay for health care might fly. Although people don't like taxes, states have found that sales taxes are more palatable than income taxes. What's more, if the VAT came with a voucher to pay for health insurance, most people would gain way more in insurance coverage than they'd pay in VAT.

A few bells and whistles would be needed to make the package work. For people who get qualifying insurance at work, the voucher would be transferable to the employer, who would have to give it back to employees in their paychecks.

To offset the burden of the VAT on low-income working families (who spend all of their incomes on necessities so can't afford higher prices), a refundable income-tax credit would cover the VAT that a family at the poverty threshold would expect to pay. This idea echoes the "prebate" proposed by advocates for a national retail sales tax (or "fair tax").

A 10 percent VAT would pay for the voucher and tax credit. Over time, the VAT could be expanded to cover the costs of other federal health programs, making real income-tax reform, including significantly lower rates, a possibility.

A VAT earmarked for health care would help slow health-care costs because, if health spending continues to grow unabated, the VAT rate will go up and up, building pressure on politicians and health-care providers to restrain costs. This dynamic contrasts with the current system, in which many people think that health insurance is almost free, paid for by employers or the government.

A new tax might sound like a political fantasy, but an outspoken advocate of this approach has been Ezekiel Emanuel, the brother of Obama Chief of Staff Rahm Emanuel and an adviser to the president on health care.

The worst thing we could do would be to create another expensive health-care entitlement without figuring out how to pay for it. That would be hazardous to our children's health.

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