**Health Reform in California: Three Simple Steps**

*Testimony of John R. Graham, Director, Health Care Studies, Pacific Research Institute*

*California State Senate Standing Health Committee (Sen. Diane Alquist, Chair)*
*Informational Hearing on the "Outlook for Health Reform"*
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Thank you for inviting me here to speak today. I am John R. Graham, Director of Health Care Studies at the Pacific Research Institute for Public Policy. I recently edited a book, *What States Can Do to Reform Health Care: A Free Market Approach*. I am also the author of the annual *U.S. Index of Health Ownership*, which ranks states' health policies according to principles of individual choice; the monthly *Health Policy Prescriptions* series, which addresses national issues; and a monthly article in PRI's *Capital Ideas* series, which addresses California issues. I also blog a few times a week at www.statehousecall.org. I have been a patient in the United States, Canada, Britain, France, and Germany.

PRI's mission is to champion freedom, opportunity, and personal responsibility by advancing free-market policy solutions. These are the principles that made America great. Regrettably, other than K-12 education, there is likely no area of American domestic life where these principles are ignored more than in health care. Instead, state power compels American families to surrender their health-care resources to agents chosen by the government.

Through a malignant provision of the Internal Revenue Code, the federal government forces most working Americans to accept health benefits chosen by their employer, and most of the rest to become dependent on the state. Reforming this flaw lies with Congress. Nevertheless, states can do many things to improve their citizens' free choice of health care. Given time constraints, I will focus on three.

1) <u>Repeal the "California Sick Tax" by making Health Savings Account contributions and earnings tax deductible</u>. California is a state with a uniquely high income tax – and it is going higher. It is also one of only four states that continue to punish residents by taxing this valuable tool. A Health Savings Account and its accompanying High-Deductible Health Plan are simply means of transferring more health-care dollars from American businesses to American families. Latest evidence shows that the rate of growth in these accounts is slightly higher than that of IRAs at a similar stage of development, and that premiums for HSA-qualified policies are between 10 percent and 40 percent lower than those of other policies.[1] California's failure to give its residents tax relief has resulted in an aggregate "sick tax"of approximately $170 million, to date – health-care funds that the state has taken from Californians to serve its needs instead of theirs.[2]

2) Give public-sector employees' the opportunity of HSAs. In a time of fiscal crisis, when state and local retirees' health-care benefits threaten to overwhelm citizens' ability to bear the burden of government, it is folly for any state to ignore this cost-saving measure for its government employees. A few days ago, *USA Today* reported that California is in the worst shape of any state, with an unfunded retiree health liability of $48 billion.[3] State politicians need to protect taxpayers from this tsunami by giving public-sector employees HSA-qualifying, consumer-driven health plans, and educating them about their advantages.

3) Free health insurers to compete. In a misguided attempt to make health insurance "fair", California has artificially segmented group-purchased health insurance from individually purchased health insurance.

   - The former lies burdened by state-mandated benefits, such as fertility treatment, that decrease wages, increase employees' hours worked, and deprive some workers of health benefits altogether. Each additional mandated benefit increases the number of uninsured by about one quarter of one percent, very roughly estimated.[4] Furthermore, AB 1672, passed in 1992, imposed modified community rating and guaranteed issue for small-group health insurance. Basically, this means that insurers cannot price premiums according to applicants' risk factors: a smoker and a non-smoker pay the same rates. The individual market has taken up the slack for workers whose employers are no longer able to afford over-regulated group health benefits. In 1993, 57 percent of Californians had employer-sponsored health insurance. It dropped to 55 percent by 2006. Individually purchased health insurance increased by the same 2 percentage points, from 7 percent to 9 percent, while the total share of uninsured plus those dependent on government programs remained about the same, at 36 percent.[5] This was despite Medi-Cal's almost doubling spending between 1997-1998 and 2006-2007.[6]

   - These rules also caused a death spiral for association health plans, because healthy people quit them and bought individual health insurance instead, leaving only the sick to buy association health plans. Association health plans used to be so popular that professional associations used them as a recruiting tool. Now, less than a quarter of 1,020 associations recently surveyed still offer them. Even the few large associations that still do, such as the California Association of Realtors, are likely to bail out.[7]

   - This excessive government interference in private health choices is a major reason why California ranks a lowly 44th out of 50 states in the *U.S. Index of Health Ownership*.[8] The state would best serve Californians' health-care needs by removing these harmful small-group regulations. At best, it would explore methods to eliminate the tax-prejudice against individually purchased health insurance entirely, like Missouri did with its HB 818.[9]

Thank you for your time.

[1] Benjamin Zycher, *HSA Health Insurance Plans After Four Years: What Have We Learned?* (New York, NY: Manhattan Institute for Policy Research, February 2009).
[2] Pacific Research Institute, *California Sick Tax Clock* (San Francisco, CA: Pacific Research Institute for Public Policy Research, at http://health.pacificresearch.org/ca-sick-tax-clock.
[3] Dennis Cauchon, "Retiree health care issue 'goes nowhere' in Nebraska", *USA Today* (February 16, 2009).
[4] John R. Graham, *From Heart Transplants to Hairpieces: The Questionable Benefits of State Benefit Mandates for Health Insurance* (San Francisco, CA: Pacific Research Institute, July 2008).
[5] California HealthCare Foundation, *Snapshot: California's Uninsured 2007*, p. 5.
[6] John R. Graham, "California Budget Has Not Solved the Medi-Cal Crisis", *Capital Ideas* (Sacramento, CA: Pacific Research Institute, September 24, 2008).
[7] John R. Graham, *California Health Care Deforminator: Model ABX1 1* (San Francisco, CA: Pacific Research Institute), pp. 26, 34.
[8] John R. Graham, *U.S. Index of Health Ownership*, 2nd edition (San Francisco, CA: Pacific Research Institute, August 2008).
[9] John R. Graham, *California Health Care Deforminator: Model ABX1 1* (San Francisco, CA: Pacific Research Institute), p. 35.