KRUGMAN ON THE CADILLAC-AS-CHEVY

A number of people have pointed to this Krugman post, in which he seemingly agrees with the excise tax apologists.

I think that states his position too strongly. What Krugman does is argue is that it makes sense to limit the tax exclusion for benefits. At the same time, he admits there are problems with imposing the excise tax as a flat dollar amount, not least because it'll end up targeting older workers and those with chronic medical issues. In that stance, Krugman endorses a key point raised by excise tax critics—that it is taxing people who need the insurance, rather than just the affluent.

Here's how Krugman weighs in on the Excise Tax Raise claim.

> Second, there's the argument that any reductions in premiums won't be passed through into wages. I just don't buy that. It's true that the importance of changing premiums in past wage changes has been exaggerated by many people. But I'm enough of a card-carrying economist to believe that there's a real tradeoff between benefits and wages.
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> Maybe it will help the plausibility of this case to notice that we're not actually asking whether a fall in premiums would be passed on to workers. Even with the excise tax, premiums are likely to rise over time — just more slowly than they would have otherwise. So what we're really asking is whether *slowing the growth of premiums* would reduce the squeeze rising health costs would otherwise have placed on wages. Surely the answer is yes.

I'll come back to that, but first I want to treat his rebuttal of the third complaint about the excise tax–that it targets unions that have exchanged salary increases in the past for benefits–because I think it is illustrative to the question of the Excise Tax Raise.

> The last argument is that this hurts unions which have traded off lower wages for better benefits. This would be a bigger issue than I think it is if the excise tax were going to kick in instantly. But it won't, giving time to renegotiate those bargains. And bear in mind that this kind of renegotiation is exactly what the tax is supposed to accomplish.

Krugman suggests, I think, that the unions that will be disproportionately affected by this tax will have three years to negotiate new contracts that (presumably) take more compensation in wages and less in health care.

Nationally, one of the unions that will be most affected by this is AFSCME–national, state, and local government workers. The teachers unions are also likely to be affected.

So what do you think the chances are, in an economic environment in which many states are struggling to close budget deficits, in which states are cutting basic services and educational resources dramatically, that any contract renegotiation in the foreseeable future would involve a one-to-one swap of wages for health care costs or even any raise at all? What are the chances that elected government officials would give public employees salary increases when all their constituents were struggling, rather than putting that money back into the services that constituents need?

Not. Gonna. Happen.

In another economic environment, unions might be in a position to negotiate for raises to offset hits to their benefits package. But not in this economic climate, not these unions.

Which brings me back to Krugman's take on the Excise Tax Raise.

Krugman starts by ceding that "the importance of changing premiums in past wage changes has been exaggerated by many people." "The Shrill One" is being polite here in not naming names. But the report he links—the EPI report I've cited—introduces the claim this way:

> Jonathan Gruber, an economics professor at M.I.T., argued in an op-ed in the Washington Post on December 28, 2009:
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> > And when firms reduce their insurance generosity, they make it up in higher pay for their workers. We saw this in the late 1990s, when the rise of managed care temporarily lowered insurance costs, and wages rose in real terms for the first time in many years. But as soon as managed care was weakened and health costs rose again, we once again saw flat or declining real wages in the United States. (Gruber 2009)

The paper then goes on to name Ezra Klein and NYT's David Leonhardt as the others making this claim.

In other words, Krugman starts by saying that Gruber and others are exaggerating the degree to which wage increases in the late 1990s were caused by a slowing rise in health care premiums. So Krugman's rebuttal is, in part, a Nobel Prize winner affirming that the excise tax's biggest boosters are overselling their case.

And in fact, Krugman's endorsement of the relationship is much more measured. He reformulates the one-to-one claim that excise tax boosters are making this way:

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> premiums would be passed on to workers. Even with the excise tax, premiums are likely to rise over time — just more slowly than they would have otherwise. So what we're really asking is whether *slowing the growth of premiums* would reduce the squeeze rising health costs would otherwise have placed on wages. Surely the answer is yes.

I find the claim that "slowing the growth of premiums would reduce the squeeze rising health costs would otherwise have placed on wages" completely uncontroversial. Yes, health care cost is one element in the overall calculation of wages, and if it continues to skyrocket, it'll contribute to continued wage stagnation. Yes, if employers are paying bajillions in health care, they're probably not also paying bajillions in salary, unless the employer in question is Goldman Sachs.

By by reformulating this from a one-to-one correspondence into one source of pressure on wages, Krugman allows for the inclusion of a bunch of other factors in the calculation. One of the reasons wages rose in the late 90s—particularly among the almost half of workers who don't get health insurance through work that the EPI looks at—is because the labor market in general was tight. That gave employees—whether they had health care or not, whether they were unionized or not—the leverage to negotiate for higher wages (and health care, in some cases).

One of the points I have been making when I challenge this Excise Tax Raise myth is that, in this job market, the claim that employers are going to share any savings with employees is just farcical. Hell, in this competitive business environment—in which businesses in most segments are struggling mightily to stay profitable—they're not going to do it. The fundamental problem with the Excise Tax Raise myth is that it gives no consideration to the overall state of the economy in its calculations. If we have a booming recovery between now and 2012, when employers will begin to make changes in anticipation of the excise tax, workers might have the leverage to demand raises. But everything my favorite Nobel Prize winning economist says about the recovery makes me doubt it will be that strong.

Which brings us, finally, to this part of the statement.

> we're not actually asking whether a fall in premiums would be passed on to workers

We're not?

Seriously, I'd love to have Krugman actually look at this claim and look at the JCT's numbers, because I think that is, in fact, what JCT has assumed, and I think that is, in fact, what Gruber claims will happen. Here's what JCT has said:

> We expect that consumers will seek less costly policies that will reduce their exposure to the excise tax. Cost reductions could be achieved through several strategies, ranging from managed care plans and limited provider networks to more out-of-pocket cost sharing by consumers. When employers offer employees less costly plans, the employees will have less compensation in the form of non-taxable health care benefits and more in the form of [taxable] cash compensation. [my emphasis]

All that language about "less costly" and "cost reductions" sure seems to envision savings, all in an environment in which health care costs have never ceased rising.

JCT calculates that the primary source of revenues from the excise tax will come from raises that workers will get. So even assuming the recovery is stronger than I think even Krugman or I believe it will be, if you're assuming raises that wouldn't otherwise happen, aren't you in fact, assuming that those raises would come from somewhere. Or, assuming the JCT assumptions are wrong, doesn't the excise tax at least depend on employers' having profitability that they wouldn't otherwise have?

My understanding–and I'm not an economist of any sort, much less a Nobel Prize winning one–is that the excise tax is assuming that there will be new funds available to employers that–they implausibly claim–will mostly be passed onto workers. And if not, it will result in new profits that can then be taxed.

The biggest problem with this claim is that employers have already been making precisely kinds of moves that excise tax supporters argue they'll do in response to the tax: moving from Platinum or Gold insurance plans to Silver ones as a way to minimize the increase in costs in health care they have to pay. And we've not seen the raises or, even, much increase in profitability.

Businesses are already doing precisely what the excise tax incents–and they've been doing it for years (as an economist named Jonathan Gruber has pointed out).

Yet that doesn't seem to have had a noticeable affect on tax revenues, much less a noticeable affect on wages, not in this crappy economy. Rather, it is the overall economy, and not the benefits calculations that individual employers are making, that seems to be the real driver of wages and tax revenues.

Again, I'm not an economist, so if someone actually wants to do the calculations of the effects of all the down-shifting in health care plans that has occurred over the last decade, I'd like to see it. I'd really welcome some evidence to support these arguments. But I'm not seeing it.

But all this comes back to the big problem with

Gruber’s undisclosed role in the Administration’s formulation of this policy. Krugman suggests (though he doesn’t say it directly) that Gruber has been exaggerating. Yet Gruber has, in some way, provided the basic assumptions behind the Administration’s plans. Did he use more realistic assumptions when he did his simulations? Or did he exaggerate the benefit of the excise tax in his assumptions? And what is the relationship between the JCT prediction about the excise tax and any simulations Gruber did before them?