



JOINT ECONOMIC COMMITTEE DEMOCRATS



SENATOR JACK REED (D-RI) – RANKING DEMOCRAT

ECONOMIC POLICY BRIEF

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ADMINISTRATION'S HEALTH INSURANCE TAX CREDIT PROPOSAL FAILS TO PROVIDE A REAL SOLUTION TO THE UNINSURED

The Bush Administration's FY 2007 Budget likely will once again feature more tax subsidies for health insurance, including a limited, refundable tax credit for uninsured low-income households. Unfortunately, if it is similar to the tax credit proposed in last year's budget, the new proposal will fail as a meaningful plan to increase insurance coverage among the low-income population.

The tax credit proposal in last year's budget did not provide nearly enough assistance to make health insurance affordable to low-income families not covered by an employer-sponsored or public insurance plan. Nor did it address the lack of availability and access to health insurance in the non-group market. The value of the credit was only large enough to finance less than 20 percent of the cost of a typical non-group family plan, and would have fallen over time relative to the increasing cost of insurance. Perversely, a tax credit only for non-group coverage could entice some employers to discontinue health coverage for middle- and low-income workers, potentially increasing the number of uninsured.

The Proposal

The proposal in last year's budget would have provided a refundable tax credit of up to \$1,000 for each adult and \$500 per child for up to two children. A married couple with two children could qualify for a maximum credit of \$3,000 to assist them in buying private health insurance in the non-group market. The credit could be paid in advance to meet the monthly

premiums when they are due. Individuals earning up to \$15,000 per year and families earning up to \$25,000 per year would be eligible for the full credit. The credit would be phased out between \$15,000 and \$30,000 for individuals and between \$25,000 and \$60,000 for families (for a family with one adult, the credit would phase out at \$40,000). Those with private employer coverage and those eligible for Medicare, Medicaid, or other government-provided health insurance would not be eligible for this tax credit.¹

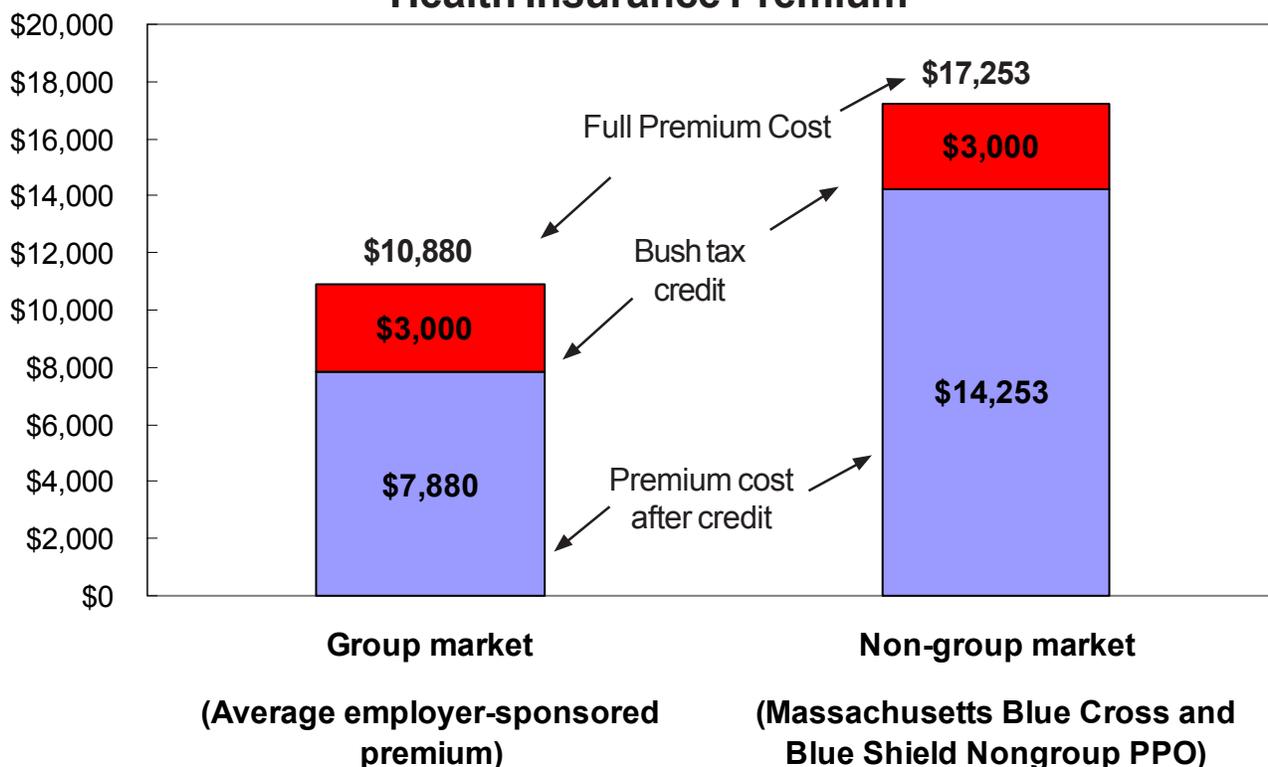
Health Insurance Would Remain Unaffordable

One important flaw in the Administration's proposal is that the tax credit is simply too small to allow low-income, uninsured people to afford coverage in the open market. According to the Kaiser Family Foundation/Health Research and Educational Trust's 2005 Employer Health Benefits Survey, the average employer-sponsored health insurance policy costs \$4,024 for an individual plan and \$10,880 for a family plan. Even if people could get coverage at this group rate (which is unlikely because of the higher costs typically found in the non-group market), the tax credit would cover slightly more than one-quarter of the cost (**Chart 1**). That subsidy is substantially less than the typical subsidy received by an employee in an employer-provided plan, which averages 75 percent for a family plan and 85 percent for an individual plan.²

The situation is even worse, however, because the non-group plans that would actually be available to people eligible for the tax credit typically are significantly more

Chart 1

Impact of Bush Health Insurance Tax Credit Proposal on a Family's Health Insurance Premium



Note: The chart uses the average 2005 premium from the Kaiser Family Foundation/Health Research and Education Trust Employer Health Benefits Survey and a Massachusetts Blue Cross and Blue Shield Nongroup PPO for a 35-yr-old family with two children in the Boston area with a \$250 deductible. See http://www.mass.gov/doi/Consumer/plan05_12_pg3.pdf. Massachusetts, unlike most states, does not allow coverage denials, only allowing rate differentials based on age and geographic regions. However, depending on whether the enrollee had prior coverage, families and individuals could face a potential 6-month waiting periods for enrollment.

Source: The Kaiser Family Foundation/Health Research and Educational Trust, 2005 Annual Employer Health Benefits Survey and the Commonwealth of Massachusetts, Division of Insurance.

expensive than group policies. For example, in the Boston area, a family with two children headed by a 35-year old could expect to pay \$17,253 for a non-group plan (Chart 1). Getting coverage could be harder or more expensive elsewhere, and any coverage offered would likely exclude benefits and impose significant cost sharing.

It is hard to see how individuals with incomes low enough to qualify for the tax credit could afford the premiums they will face, even after subtracting the value of the tax credit from the total premium cost. A family of four must earn less than \$25,000 to be eligible for the full credit, yet that family is likely to face insurance

costs in the non-group market of more than \$10,000—even with the \$3,000 credit.

Experience with the Health Coverage Tax Credit (HCTC), created as part of the Trade Act of 2002, is instructive. That credit pays 65 percent of qualified health insurance premiums for certain workers displaced by international trade or receiving pension payments through the Pension Benefit Guaranty Corporation. The credit is refundable and payable in advance to the insurer, which means that workers can receive the credit when they pay for insurance and need not wait until they file tax returns after the end of the year.

Despite covering a significant portion of insurance premiums and providing advance payment directly to insurers, the HCTC has a low take-up rate. As of the fall of 2004, only about 6 percent of all potentially eligible participants received advance payment of the credit.³ The actual participation rate may be closer to 20 percent after including possible participants who did not claim advance payments, and excluding potentially eligible workers who were disqualified because they had access to other insurance. The inability of eligible workers and retirees to pay 35 percent of the premiums appears to be the most significant reason for the low take-up rate, although other problems including complexities in enrollment, delays in initial advance payments, and the quality of the health coverage offers, may have inhibited higher participation.⁴

Access to Non-Group Coverage is Not Guaranteed

A second major flaw in the Administration's tax credit plan is that it does nothing to guarantee that those eligible for the credit will in fact have access to coverage. The non-group market is loosely regulated at the state level, with regulations varying substantially from state to state. Premiums, deductibles, and cost-sharing in this market are typically greater than those for employer-sponsored coverage, and non-group coverage is not guaranteed in most states. In contrast to employer-sponsored plans, where risks are spread across a group of employees, insurance companies are generally allowed to use medical underwriting to vary premiums for non-group policies according to the health status of the applicant. Insurance companies often deny coverage to older or less healthy applicants and they can exclude certain medical conditions, such as maternity coverage or cancer treatment for a previous cancer survivor, making the insurance virtually useless.

A 2001 study conducted for the Kaiser Family Foundation at Georgetown University's Health Policy Institute tested access in the non-group market. Hypothetical candidates for health insurance were created, and insurance companies evaluated their chances for coverage and the rates they could expect. The find-

ings suggest that a 48-year-old seven-year breast cancer survivor could expect premiums for individual insurance approaching \$4,000 per year (with 43 percent of insurers refusing to offer coverage), and a 62-year-old smoker with high blood pressure would be forced to pay premiums for individual insurance up to \$10,000 or more (with a 55-percent denial rate). Even younger, healthy uninsured people would experience high premiums and some coverage refusals or disease exclusions.⁵ In addition, estimates have suggested that deductibles average between \$1,550 and \$2,235 in the non-group market.⁶

The Value of the Tax Credit Erodes over Time

Yet another flaw in the Administration's tax credit proposal is that it will not keep pace with the rising costs of health insurance. Health insurance premiums have increased at double-digit rates in four of the past five years, with another substantial increase expected in 2006.⁷ Yet the amount of the tax credit is indexed to the increase in the overall price level, which historically has been substantially lower than the recent rate of increase in health insurance premiums. Thus, the value of the credit in offsetting the cost of health insurance will decline over time. As a result, the number of uninsured people who would find the tax credit advantageous, which is unlikely to be large even at the outset, will shrink significantly over time.

Employer Coverage Is Threatened

Researchers at the Tax Policy Center estimated that the President's tax credit proposal would cause about 3.4 million workers to lose employer-sponsored coverage because many employers would choose to drop coverage. Of those, about 2.1 million would switch to non-group insurance or become covered by Medicaid, while the remaining 1.3 million previously insured workers would become uninsured. The study also found that only about 3.1 million currently uninsured people would take-up the credit—about 7 percent of the uninsured. Thus, the total number of insured would increase by about 1.8 million, but significantly fewer workers would be covered by employer-sponsored insurance.⁸

Conclusion

If the Administration proposes a tax credit for the purchase of health insurance that is similar to those it has proposed in the past, that proposal will fail the critical tests of affordability and access. Providing \$1,000 to low-income individuals and \$3,000 to a low-income family would do little to help them afford rapidly rising health insurance premiums. Moreover, by forcing the uninsured to shop for coverage in the unregulated, non-group health insurance market, the Administration would be putting millions of Americans at risk of being denied coverage or forced to accept extremely high deductibles, cost sharing, or coverage exclusions. Such a proposal is inadequate and would not have any significant impact in reducing the number of uninsured.

(Endnotes)

¹ Department of the Treasury, *General Explanation of the Administration's Fiscal Year 2006 Revenue Proposals, February 2005*, pp.19-22.

² The Kaiser Family Foundation/Health Research and Educational Trust, 2005 Annual Employer Health Benefits Survey, <http://www.kff.org/insurance/7315/sections/upload/7316.pdf>.

³ Julie Stone-Axelrod and Bob Lyke, "Health Coverage Tax Credit Authorized by the Trade Act," CRS Report for Congress, RL 32620, updated February 8, 2005.

⁴ Stan Dorn, Janet Varon, and Fouad Pervez, "Limited Take-Up of Health Coverage Tax Credits: A Challenge to Future Tax Credit Design," The Commonwealth Fund, Issue Brief, October 2005.

⁵ For detailed examples of coverage denials and pre-existing condition exclusions, see K. Pollitz, R. Sorian, and K. Thomas, *How Accessible Is Individual Health Insurance for Consumers in Less-than-Perfect Health?* (Menlo Park, Calif.: Henry J. Kaiser Family Foundation, June 2001).

⁶ J. Gabel et al, "Individual Insurance: How Much Financial Protection Does It Provide?" 17 April 2002, <http://content.healthaffairs.org/cgi/content/full/hlthaff.w2.172v1/DC1>.

⁷ The Kaiser Family Foundation/Health Research and Educational Trust, 2005, *op. cit.*

⁸ Leonard E. Burman and Jonathan Gruber, "Tax Credits for Health Insurance", Urban-Brookings Tax Policy Center, Tax Policy Issues and Options, No. 11, June 23, 2005.