JOINT ECONOMIC COMMITTEE DEMOCRATS

SENATOR JACK REED (D-RI) – RANKING DEMOCRAT

ECONOMIC POLICY BRIEF — UPDATED APRIL 2006

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

The Bush Administration's FY 2007 Budget once again features tax subsidies for health insurance, including a limited, refundable tax credit for low-income households. Unfortunately, the credit, which would be available only to those who purchase high-deductible health insurance and who are not covered by a public or employer-sponsored group health plan, fails as a meaningful plan to increase insurance coverage among the low-income population.

The proposed tax credit would not provide nearly enough assistance to make non-group health insurance affordable to low-income families. The maximum credit is only large enough to cover approximately 20 percent of the premiums for a typical non-group family plan, and will fall over time relative to the increasing cost of insurance. Nor would it address the lack of availability and access to health insurance in the non-group market. Perversely, a tax credit that excludes employer-sponsored group plans could result in some employers discontinuing health coverage, potentially increasing the number of uninsured.

The Administration's Proposal

The Administration's budget proposes a new refundable health insurance tax credit for health insurance premiums paid by low-income households. The Administration's proposed credit is limited to premiums for high-deductible health insurance plans (HDHPs) purchased in the individual non-group market. In past years, the Administration had proposed a tax credit that would apply to all health insurance plans purchased in the non-group market, not just high-deductible plans.

The tax credit would equal up to 90 percent of the health insurance premium (up to a maximum dollar amount) of an eligible HDHP. An eligible HDHP plan in 2006 must have a deductible of at least $1,050 for individual coverage and $2,100 for family coverage. Those with private employer coverage and those covered by Medicare, Medicaid, or other government-provided health insurance would not be eligible for the credit.[1]

A married couple with two children could qualify for a maximum credit of $3,000, while a single adult could qualify for a maximum credit of $1,000.[2] The credit is refundable, which means that a family would receive the full credit for which it is eligible even if the credit exceeded its income tax liability. The credit is also payable in advance to meet 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. Those with higher income would receive a reduced credit, but individuals with income of $30,000 or more and families with income of $60,000 or more ($40,000 in the case of a family with a policy that covers just one person) would be ineligible.

Higher-income families would not be eligible for the health insurance tax credit but could qualify for a new unlimited income-tax deduction for HDHP premiums, also proposed in the Administration's budget. In addition to the tax deduction, households could also claim a 15.3 percent refundable credit for HDHP premiums (up to a maximum of earnings subject to employment taxes). As with the health

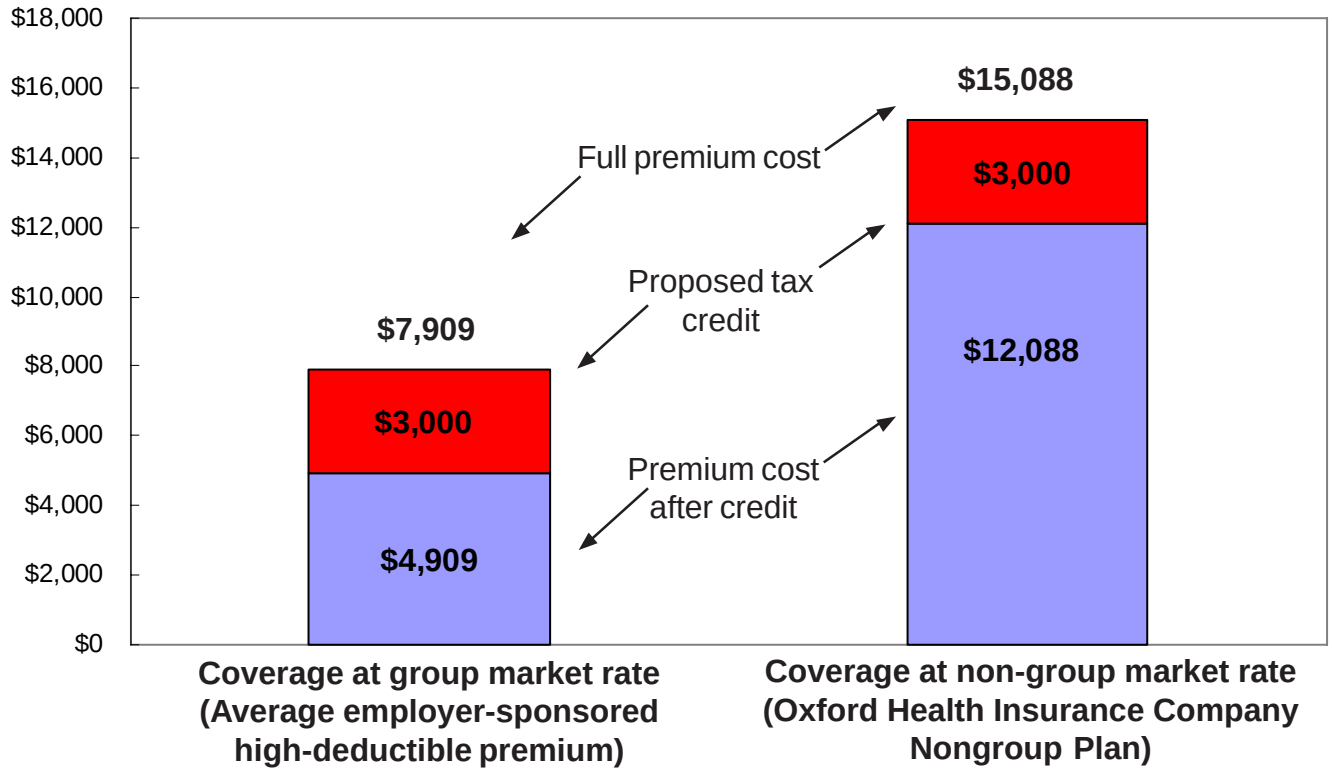
insurance tax credit, the income tax deduction (and the 15.3 percent credit) would only apply to premiums for high-deductible insurance purchased in the non-group market.

Health Insurance Would Remain Unaffordable

An important flaw in the Administration's proposal is that the health insurance tax credit is simply too small to allow low-income households to afford HDHP 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 high-deductible health insurance policy costs $2,700 for an individual plan and $7,909 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-third of the cost (**Chart**). 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.[3] In addition, the insured would still need to pay expenses up to the deductible amount, which must be at least $1,050 for an individual and $2,100 for a family.

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 expensive than group policies. For example, in New Jersey, a married couple with at least one child could expect to pay $15,088 or more for non-group coverage with a $2,500 deductible. Getting coverage could be harder or more expensive

Impact of Bush Administration's 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 an Oxford Health Insurance Company Nongroup plan for a family with at least one child (and a deductible of $2,500). See http://www.nj.gov/dobi/ihcseh/ihcratepage.pdf .

Source: The Kaiser Family Foundation/Health Research and Educational Trust, 2005 Annual Employer Health Benefits Survey and the State of New Jersey, Department of Banking and Insurance.

elsewhere, and any coverage offered would likely exclude benefits and impose significant cost sharing.

It is hard to see how families 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 that exceed the full credit by over $12,000.

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.

Despite covering 65 percent 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.[4] 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 available health coverage, may have inhibited higher participation.[5]

The Value of the Tax Credit Erodes over Time

Not only is the Administration's proposed tax credit too small to provide meaningful assistance to lower-income families, the amount of the credit will not even 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.[6] Yet the proposed tax credit is indexed to the increase in the medical care component of the 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.

Access to Non-Group Coverage is not Guaranteed

The Administration's health insurance tax credit proposal 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 for many families.

A 2001 study conducted for the Kaiser Family Foundationby researchers 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 findings 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.[7] The President's proposal to limit the credit to HDHP's would not necessarily increase offer rates, since estimates suggest that deductibles already average between $1,550 and $2,235 in the non-group market.[8]

Employer Coverage is Threatened

By providing a new subsidy only for health insurance purchased in the non-group market, the proposed tax credit

would weaken the tax incentive for employer-sponsored coverage. Some employers may choose to drop coverage. Even if the percentage of employers who drop coverage is small, a significant number of lower-income households could lose coverage. Not all of the households will be willing or able to purchase coverage in the non-group market.

MIT economist Jonathan Gruber estimates that the low-income health insurance tax credit proposed by the Administration would cause about 2.2 million workers to lose employer-sponsored coverage. Of those, about 1.1 million would obtain coverage either in the non-group market or through Medicaid, while the remaining 1.1 million previously insured workers would become uninsured. Gruber also estimates that only about 2.4 million currently uninsured people would take-up the credit—about 5 percent of the uninsured. Thus, while the total number of insured would increase by about 1.4 million, significantly fewer workers would be covered by employer-sponsored insurance.[9]

Conclusion

The Administration's proposal for a tax credit to purchase high-deductible health insurance fails the critical tests of affordability and access. Providing $1,000 to low-income individuals and $3,000 to low-income families 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 Explanations of the Administration's Fiscal Year 2007 Revenue Proposals, February 2006*, pp.21-27.
[2] The maximum credit would be $1,000 for a policy covering only one adult or one or more children, $2,000 for a policy covering two adults or one adult plus one or more children, and $3,000 for a policy covering two adults plus one or more children.
[3] The Kaiser Family Foundation/Health Research and Educational Trust, 2005 Annual Employer Health Benefits Survey, http://www.kff.org/insurance/7315/index.cfm.
[4] Julie Stone and Bob Lyke, "Health Coverage Tax Credit Authorized by the Trade Act," CRS Report for Congress, RL 32620, updated February 8, 2005.
[5] 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.
[6] The Kaiser Family Foundation/Health Research and Educational Trust, 2005, *op. cit.*
[7] 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).
[8] 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.
[9] Jonathan Gruber, "The Cost and Coverage Impact of the President's Health Insurance Budget Proposals", Center on Budget and Policy Priorities, February 15, 2006.

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