



# The Council for Affordable Health Insurance's ISSUES & ANSWERS

Solutions for Today's Health Policy Challenges

No. 101

March 2002

## *Helping the Uninsured Who Need it Most*

The economic slowdown will result in an estimated 1 million people losing their health insurance in 2002. In addition, health insurance premiums are rising about 15 percent on average, but many individuals and businesses are seeing increases of 30 percent to 40 percent. Both Congress and state legislatures are looking for a solution to the problem of the growing number of uninsured. Fortunately, there is one, and it is gaining bipartisan support.

**The Employer-Based Health Insurance System.** The U.S. has an employer-based health insurance system. About 90 percent of those under age 65 with private health insurance get it through their employer. The other 10 percent purchase health insurance on their own in what's referred to as the "individual market," much as people purchase their own auto and life insurance policies.

America has an employer-based health insurance system largely as a result of the tax code. People don't pay taxes on the money employers spend on health insurance – a significant tax-free benefit for higher-income workers and those who work for companies that purchase expensive health insurance policies.

However, while the self-employed can take a tax deduction for health insurance, those who work for employers who do not provide health coverage must buy their own with after-tax dollars. Unfortunately, these tend to be lower-income workers who find it difficult to afford a health insurance policy.

**The Bipartisan Support for Tax Credits.** To address this problem, there is a growing bipartisan consensus for providing a health insurance tax credit – which is deducted directly from the amount of taxes owed – as the fairest and most efficient way to provide a tax break to workers who purchase their own policies. Under most proposals, the credit would also be refundable, meaning people would get the credit even if they paid no income taxes.

For example, House Majority Leader Dick Arney (R-Texas) and Rep. Bill Lipinski (D-Ind.) have proposed "Fair Care" legislation that would provide a refundable tax credit of up to \$1,000 for an individual and \$3,000 for a family. President Bush has recently proposed similar legislation.

**The Impact of a Fixed Tax Credit.** Economists Mark Pauly and Bradley Herring of the University of Pennsylvania and David Song of Yale University recently analyzed the response to a tax credit for health insurance. The authors looked at a "fixed" \$1,000 refundable tax credit for self-only coverage when purchased in the individual market. According to Pauly et al., "[W]e find that 85 percent of the uninsured sample requires a subsidy of under \$1,000 for the purchase of a \$1,000 deductible PPO plan, while only 34 percent of the uninsured would respond to such a subsidy for the purchase of a [more costly] \$250 deductible plan." That is, the authors found that the take-up rate is in almost direct proportion to the amount of the subsidy.

**The Case for a Variable Tax Credit.** One of the criticisms of a fixed tax credit is that some low-income families might be unable to pay the out-of-pocket difference between the amount of the subsidy and the cost of a policy, assuming there is a difference. Moreover, some people with medical conditions are charged more for coverage because of their increased risk.

Mark Litow, an actuary and principle of the actuarial firm Mil-

Variable Tax Credits for Low-Income & Uninsurable Populations					
Income Per Household	Basic Per Person Tax Credit	Additional Tax Credit Based On Income	Total Tax Credit for Insurable Individual	Additional Tax Credit for Uninsurable Individual	Total Tax Credit for Uninsurable Individual
\$17,000+	\$800	\$0	\$800	\$400	\$1,200
\$7,500 to \$17,000	\$800	\$560	\$1,360	\$680	\$2,040
Less than \$7,500	\$800	\$1,380	\$2,180	\$1,090	\$3,270

Source: SimuCare.

liman USA, in conjunction with the Council for Affordable Health Insurance (CAHI), have addressed this problem. They have determined that tax subsidies can be structured to meet the needs of both the low-income and the hard-to-insure populations.

**The Structure of a Variable Tax Credit.** According to Litow, using Milliman's SimuCare econometric model, the federal government could provide a flat \$800 per-person annual tax credit to subsidize the cost of a policy, or \$3,200 for a family of four. Depending on a number of factors – including age, health status, geographical location, number in the family and, perhaps most importantly, the type of policy chosen – an \$800 per-person annual tax credit would cover between 33 percent and 90 percent of the cost of a health insurance policy.

*Low-Income Workers.* Of course, a tax credit that covered \$800 (or two-thirds) of a \$1,200 premium would still leave a \$400 difference, which could be difficult for a very low-income worker to pay. Thus, the Litow-CAHI proposal provides more tax credit money to low-income working families. As the table shows:

- Workers making between \$7,500 and \$17,000 a year would receive an additional \$560 on top of the basic \$800 credit, for a total of \$1,360.
- And those making less than \$7,500 a year would receive \$1,380 in addition to the \$800, for a total of \$2,180.

This additional tax credit money targeted to low-income workers would make it possible for the large majority to purchase health insurance with little or no additional money out of pocket.

*People with Preexisting Medical Conditions.* Another important category is those who cannot qualify for health insurance at standard rates because of a preexisting condition. While most states have a mechanism to ensure that people with preexisting conditions can get coverage, these people often must pay higher premiums. For example, 28 states have high-risk pools, which accept those denied health insurance in the private market. In most of these states, participants pay between 25 percent to 50 percent more than if they were healthy.

To address this additional cost, the Litow-CAHI approach factors in an increase of between \$400 and \$1,090 per person per year, depending on income. Thus:

- A middle-income family of three with two healthy people and one with a preexisting condition could expect a total tax credit of \$2,800 (\$800 each for the two healthy members and \$1,200 for the one with a preexisting condition).

- In contrast, a similar low-income (\$7,500-\$17,000) family of three could expect to receive as much as \$4,760 (\$1,360 each for two and \$2,040 for the member with a preexisting condition).

**The Cost of Expanding Coverage.** How much would such a program cost the government? Assuming the credit is going to those who do not have health insurance or are not already getting a tax break through their employer, Litow estimates the legislation would cost between \$20 billion and \$25 billion a year. If the tax credit were made available to all workers under age 65 – a much more comprehensive proposal than Congress is considering – it would cost an additional \$20 billion to \$25 billion a year, for a total annual cost of \$40 billion to \$50 billion.

**Saving Medicaid while Saving Money.** Were Congress to decide to include Medicaid reform at the same time it created a tax credit for all workers, Medicaid recipients could also use a refundable tax credit to purchase a private insurance policy. Ironically, including Medicaid recipients in the tax credit structure *would make the reform budget neutral*, meaning there would be no additional cost to the government. Since Medicaid is so costly and inefficient, the government could provide current recipients with a very generous refundable tax credit to buy a policy with almost no out-of-pocket costs and still save \$40 billion to \$50 billion a year – enough to offset a new tax subsidy given to all workers, according to the Milliman USA model.

**Conclusion.** Creating a variable tax credit system is not without problems. For example, it would give taxpayers an incentive to underreport income in order to receive a larger subsidy. But a tax credit would be the most efficient way to assist those who do not get health insurance through an employer. And a variable tax credit would address the concerns of those who believe that a fixed credit is too inflexible to help workers with very low incomes or preexisting conditions.

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