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WOULD TAX INCENTIVES BE AN EFFECTIVE WAY TO EXPAND HEALTH COVERAGE FOR LOW-INCOME CHILDREN AND FAMILIES?

by Judith Solomon

In recent weeks, the Administration has threatened to veto legislation in Congress that would reauthorize the SCHIP program and extend health coverage to several million uninsured children. As an alternative, the Administration has touted the virtues of the private insurance market and attempted to revive consideration of its proposal to provide a tax deduction for the purchase of health insurance. As explained below, however, the proposed tax deduction would not make private coverage affordable for most low-income families because of the high premiums and large out-of-pocket costs associated with individual-market plans.

About half of the nation's uninsured low-income families would not benefit at all from the proposed tax deduction because they do not owe federal income taxes. In addition, uninsured families with moderate incomes would receive only modest tax benefits because they are in the 10 or 15 percent tax bracket.[1] While the Administration has expressed willingness to replace its proposed tax deduction with a modest refundable tax credit, which would provide the same assistance to

KEY FINDINGS

- As an alternative to strengthening SCHIP, the Administration has proposed creating a tax deduction for the purchase of health insurance (and has indicated it could accept a tax credit instead). But even with such a tax benefit, most low-income families would not be able to buy adequate coverage in the individual health insurance market.
- One recent study found that 72 percent of low-income people who tried to buy insurance in the individual market found it very difficult or impossible to find coverage that was affordable; 26 percent were refused coverage or charged more because of a pre-existing health condition.
- Other studies show that individual-market coverage could cost one-third of a low-income family's income, when both premiums and the plans' high out-of-pocket costs are considered.
- The high out-of-pocket costs often required in individual health insurance plans could also force families to do without needed care. Studies indicate that low-income people often cope with high cost-sharing in their health plans by going without necessary health-care services.
- In addition, tax subsidies for the purchase of individual health insurance would likely encourage some employers to cease offering health insurance to their workers, on the assumption that workers could obtain coverage on their own.

[1] Sherry Glied and Dahlia Remler, "The Effect of Health Savings Accounts on Health Insurance Coverage," The Commonwealth Fund, April 2005. See also Jonathan Gruber, "Tax Subsidies for Health Insurance: Evaluating the Costs and Benefits," Kaiser Family Foundation, January 2000.

families at all income levels, such a credit still would be unlikely to make coverage in the individual market affordable for low-income families.

Moreover, since individual-market plans (as well as some employer-sponsored plans) can impose substantial deductions and co-payment charges that can operate as a barrier to care for low-income families, and also can lack coverage for certain health-care services that some children need, a number of families with access to these plans may find that enrolling their children in Medicaid or SCHIP is a better alternative for their children's health.

Many Low-Income Families Cannot Afford Premiums for Individual-Market Coverage

Most people who try to purchase coverage in the individual market end up not buying it.[2] The Commonwealth Fund Biennial Health Insurance Survey, a national survey conducted from late 2005 through early 2006, found that most adults who attempted to purchase coverage in the individual market did not succeed in getting it. The problem is especially severe for people with incomes below 200 percent of the poverty line:

- 72 percent of low-income people (i.e., those below 200 percent of the poverty line) who tried to purchase coverage in the individual market found it very difficult or impossible to find affordable coverage; and

- 26 percent of those who tried to purchase a plan were refused coverage or charged a higher price than others seeking similar coverage because of a pre-existing health condition. [3]

These findings are not surprising, given the high cost of individual-market coverage and the limited incomes of low-income families. Premiums for individual-market coverage for families with incomes between 100 and 199 percent of the poverty line cost, on average, one-quarter of the family's total income, according to analysis of data from the Medical Expenditure Panel Survey (MEPS). Similarly, families with incomes between 200 and 299 percent of the poverty line would have to pay an average of 14 percent of their income for premiums for individual-market coverage an amount well above what most experts regard as affordable for such families.[4] Faced with these costs, many families likely would forgo coverage even if a modest tax benefit were available.

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[2] If provided a tax deduction or credit to use in purchasing insurance, most families would have to try to use their tax subsidy to purchase coverage in the individual market, because most uninsured, low-income families do not have an offer of employer coverage. In 2005, only 14 percent of families with income between 100 and 199 percent of the poverty line, and only 8 percent of families with income between 200 and 400 percent of the poverty line, declined an offer of employer-sponsored insurance. Lisa Clemans-Cope, et al., "Changes in Employees' Health Insurance Coverage, 2001-2005," Kaiser Commission on Medicaid and the Uninsured, October 2006.

[3] Sara R. Collins, *et al.,* "Squeezed: Why Rising Exposure to Health Care Costs Threatens the Health and Financial Well-Being of American Families," The Commonwealth Fund, September 2006.

[4] Linda J. Blumberg, *et al.,* "Setting a Standard of Affordability for Health Insurance Coverage," *Health Affairs* web exclusive, June 4, 2007. These findings were based on an analysis of MEPS data for 2001 to 2003.

Many families that include people with chronic conditions like asthma and diabetes may not be able to purchase coverage in the individual market at any price. In most states, insurers can turn down applicants with significant health problems.[5]

Individual-Market Plans Include High Out-of-Pocket Costs That Could Force Families to Do Without Needed Health Care

In addition to large premiums, families that manage to purchase coverage in the individual market also face high out-of-pocket costs for deductibles, co-payments, and expenses that their health plans do not cover. These costs are much higher than the costs faced by people with employer-sponsored insurance or public coverage through Medicaid or SCHIP.

A recent study comparing health plans offered through the individual market, employers, and public programs found that individual-market coverage provides the least financial protection for beneficiaries, while public coverage provides the most. Regardless of their income level, families with individual-market insurance were most likely to face out-of-pocket expenses that exceeded $2,000 and constituted more than 5 percent of the family's income. This problem was especially severe for low-income people: nearly half of those with individual-market coverage paid more than 5 percent of their income for out-of-pocket expenses, on top of what they paid for premiums, presumably because their plans had high deductibles and/or high co-payments.[6]

Similarly, a California study found that individual-market insurance paid just over half (55 percent) of beneficiaries' medical costs, well below the 83 percent of medical costs paid by policies in the small-employer group market.[7]

A substantial body of research shows that low-income people often cope with high cost-sharing in their health plans by going *without* necessary health-care services. The Commonwealth Fund survey cited above found that more than one-third of those with individual-market insurance had deductibles of $1,000 or more, and that close to half (44 percent) of this high-deductible group did without at least one needed medical service, such as filling a prescription, seeing a specialist when needed, taking a test recommended by a doctor, or seeing a doctor for a health problem.

Low-income people with chronic health conditions are the most vulnerable to forgoing needed health care due to deductible and co-payment charges, as they have the most difficulty affording such charges.[8] The proposed tax deduction or credit — which would be used for the premium costs of health insurance but *not* for deductibles or co-payments — would be of little help here.

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[5] Mila Kofman and Karen Pollitz, "Health Insurance Regulation by States and the Federal Government: A Review of Current Approaches and Proposals for Change," Georgetown University Health Policy Institute, April 2006.

[6] Yu-Chu Shen and Joshua McFeeters, "Out-of-Pocket Health Spending Between Low- and Higher-Income Populations," *Medical Care,* 44:3, March 2006.

[7] "Health Insurance: Can Californians Afford It?" California HealthCare Foundation, June 2007.

[8] The research on the impact of cost-sharing on low-income people is summarized in Leighton Ku and Victoria Wachino, "The Effects of Increased Cost-Sharing in Medicaid: A Summary of Research Findings," Center on Budget and Policy Priorities, July 7, 2005.

Combination of Premiums and Out-of-Pocket Costs Makes Private Coverage Unaffordable for Many

Even if the tax deduction or credit were structured so it could apply to deductibles and co-payments as well as premiums, it would likely be ineffective in helping many lower-income families obtain coverage. Two recent studies examined the combined burden of premiums and out-of-pocket costs in individual-market coverage:

- A study based on MEPS data found that families with incomes between 100 and 199 percent of the poverty line that had individual-market coverage spent an average of 33 percent of their income on medical costs. Families with incomes between 200 and 299 percent of the poverty line spent 21 percent of their income on medical costs. The authors of this study suggest that these percentages would be even higher if the data were not skewed by the fact that only relatively healthy people were able to purchase individual-market coverage in the first place.[9]

- A California study found that a family of four with income of 200 percent of the poverty line that had individual-market coverage would have to spend 34 percent of its income on health care.[10] In 2007, this would amount to about $14,000, far more than any tax benefit a family at this income level would receive from any tax deduction or credit that has been proposed.

Public Coverage Often Better for Children Than Private Coverage

In recent weeks, the Administration has criticized Senate and House legislation that would extend health insurance coverage through the State Children's Health Insurance Program (SCHIP) and Medicaid to more uninsured children, on the grounds that the legislation would "crowd out" private coverage — that is, that it would cause people to substitute public coverage for existing private coverage. Leading researchers agree, however, that virtually *any* effort to expand coverage to the uninsured will result in some substitution of one type of health care for another or in the substitution of a government health care subsidy for premium costs currently being paid by a family that already is insured. In fact, the SCHIP bills being considered by Congress would cause *significantly less* crowd-out or substitution than the tax-based approaches the Administration favors.[11]

- The Congressional Budget Office estimates that about two-thirds of the children gaining SCHIP or Medicaid coverage under the children's health legislation approved by committees in the Senate and House would otherwise be uninsured. Some 34 percent of the children who would gain SCHIP or Medicaid coverage under the Senate bill, and 30 percent of those who would gain such coverage under the House bill, would otherwise have private coverage, according to CBO.

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[9] Blumberg, *et al.*

[10] Jon Gabel, *et al.,* "Trends in the Golden State: Small-Group Premiums Rise Sharply While Actuarial Values for Individual Coverage Plummet," *Health Affairs* web exclusive, June 14, 2007.

[11] For a full discussion of the shortcomings of the Administration's claims on crowd-out, see Robert Greenstein, "The Administration's Dubious Claims About the Emerging Children's Health Insurance Legislation: Myth and Reality," Center on Budget and Policy Priorities, July 17, 2007.

- In contrast to these 34 percent and 30 percent "crowd-out" rates, a study by M.I.T. health economist Jonathan Gruber — the economist whose work on SCHIP crowd-out the Administration frequently cites — found that *77 percent* of the benefits under the health tax deductions and credits the Administration proposed last year would go to people who already had insurance. Gruber also found that despite costing $12 billon a year, the Administration's tax subsidy proposals would produce *no* net reduction in the number of Americans who are uninsured, because they would induce a number of employers to drop, or not to offer, coverage.

- This is why Gruber has concluded that expansion of public programs like SCHIP is the most efficient way to cover the uninsured and is far more efficient than tax subsidies. Similarly, in response to a question at the Senate Finance Committee's "mark up" of its child health bill last week, CBO director Peter Orszag observed that the Senate bill's 34 percent crowd-out rate was probably about as efficient as a measure to reach several million uninsured children could get.

Moreover, the substitution by some low-income families of SCHIP or Medicaid coverage for private coverage should not simply be regarded as an example of inefficiency. For a number of low-income families that have access to private insurance for their children, Medicaid or SCHIP coverage is likely to be better for their children's health. The public programs are clearly preferable in most cases to coverage in the individual market. As shown above, low-income families with individual-market coverage generally spend a large share of their income on health care; by enrolling their children in Medicaid or SCHIP instead, these families can obtain much-needed relief from these costs, avoid forgoing needed care for their children when they cannot afford the deductibles and co-payments, and ensure that their children have access to needed services like dental and vision care, which individual-market policies frequently do not cover.

Even some low-income families with access to group coverage through their employer may find it beneficial for their children to opt for public coverage instead. This may be most true for families with access to small-group coverage. Employees in small firms (firms with fewer than 200 workers) are charged significantly more for health coverage for their families, on average, than workers in large firms. In 2006, the average annual employee contribution for premiums for family coverage was $3,550 in small firms, as compared to $2,658 in large firms.

Deductibles also tend to be higher for family coverage through small firms (an average of $1,499 in 2006) than large firms (an average of $838). In addition, only 49 percent of workers in small firms had dental coverage in 2006, compared to 80 percent of workers in large firms.[12] Some low-income families with access to small-group coverage may end up enrolling their children in Medicaid or SCHIP to obtain relief from overly burdensome out-of-pocket costs or to obtain needed health services for their children that their employer's plan does not offer.[13]

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[12] The Kaiser Family Foundation and Health Research and Educational Trust, "Employer Health Benefits 2006." The data on deductibles is for Preferred Provider Organization (PPO) plans.

[13] The Commonwealth Fund Survey shows that many low-income families with private insurance face large out-of-pocket costs regardless of whether they purchase the coverage in the individual market or obtain it through their employer. Two-fifths of the adults surveyed with annual incomes between $20,000 and $39,000 spent 10 percent or more of their income on their family's health care. Collins, *et al.*

Conclusion

The Administration's proposed tax subsidies for the purchase of health insurance would likely be of little help to most low-income families, given the high premiums and out-of-pocked costs associated with individual-group coverage. Moreover, such proposals would likely encourage some employers to cease offering health insurance to their workers, on the assumption that workers could obtain coverage on their own with their tax deduction or credit. Small employers, where low-income workers are most likely to work, would be the type of employer most likely to drop coverage for their workers.[14] The tax proposals consequently would be likely to reduce low-income families' already limited access to employer-based coverage.

In contrast to the Administration's tax-based approach, SCHIP and Medicaid provide low-income families with protection against high out-of-pocket costs for health care services for their children, coupled with a comprehensive benefits package that covers the health-care services that children need. The approach taken by the Senate and House bills to cover more uninsured low-income children through SCHIP and Medicaid thus represents sound policy.

[14] Edwin Park, "Administration's Standard Tax Deduction for Health Insurance Seriously Flawed," Center on Budget and Policy Priorities, July 31, 2007.