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HEALTH INSURANCE DEDUCTION OF LITTLE HELP TO THE UNINSURED

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House Speaker Dennis Hastert held a press conference last week in which he called for including in the minimum-wage package a new tax deduction for health insurance premiums. The deduction would be available to taxpayers that pay at least 50 percent of the cost of their health insurance.

This proposal, which would cost nearly $11 billion a year in fiscal year 2010, is a poorly targeted and expensive way to help the uninsured obtain coverage. Those most in need would receive little or no subsidy to help them buy insurance. Moreover, the proposal could have the effect of raising the cost of insurance for some workers.

- According to an analysis by the Joint Committee on Taxation, approximately 94 percent of the cost of the Speaker's tax deduction would go to subsidize taxpayers that already have health insurance, with only 6 percent of the tax benefits going to further his stated goal of extending health insurance coverage to the uninsured.

- The proposed tax deduction is most valuable to high-income taxpayers, who are in the higher tax brackets. Nine of every 10 people without health insurance, however, have no tax liability or are in the lowest (15 percent) tax bracket. Taxpayers with incomes too low to pay income taxes would receive no assistance in purchasing insurance from this deduction. For most taxpayers in the 15 percent bracket, the 15-cents-on-the-dollar subsidy that the deduction provides is unlikely to be sufficient to make insurance affordable.

- Because the deduction provides a far-deeper percentage subsidy for the purchase of insurance to higher-income business owners and executives than to lower-income wage earners, it could encourage small business owners to drop, or fail to institute, group coverage and to rely instead on this deduction to help defray the cost of their own coverage. As a result, some workers could be forced to buy more costly and less comprehensive insurance on the individual market, and the ranks of the uninsured and underinsured could increase.

New research shows that a far more cost effective way to assist the uninsured, particularly uninsured children, would be to extend publicly-funded health insurance coverage to low-income parents. The Administration's FamilyCare plan relies on this approach. At his press conference, however, the Speaker inappropriately compared his proposal to the Administration's small business health insurance tax credit. The Administration's tax credit is a very small scale proposal compared to the Hastert tax deduction. The Speaker's proposal costs $10.9 billion a year by 2010, while the Administration's small business tax credit would cost just $319 million over *10 years*, according to JCT. The more-appropriate comparison would have been to the Administration's FamilyCare plan, which the Congressional Budget Office estimates would cost $8.7 billion in 2010.

- Available estimates show that the FamilyCare approach would result in a substantially larger number of currently uninsured people obtaining insurance coverage than would the Speaker's proposed tax deduction. This is the case despite the somewhat lower annual cost of the FamilyCare plan, when both proposals are fully in effect.

- A recent report by the Council of Economic Advisers concludes that tax deductions will do little to improve tax health insurance coverage and that approaches like FamilyCare are better at targeting the uninsured.

Deduction Is Poorly Targeted

A Joint Committee on Taxation estimate of the Speaker's proposal indicates that the tax deduction would help 1.6 million uninsured people gain health coverage in 2007, when the 100 percent deduction is first effective. Yet the same estimate states that a total of 26 million people would benefit from the deduction. (JCT estimates that 13.1 million taxpayers would take advantage of the tax deduction and assumes that two persons are covered by each health insurance policy.)

Thus, the uninsured would represent just over 6 percent of the total number of beneficiaries of the deduction (1.6 million out of 26 million). As a result, 94 percent of the deduction's annual cost, once it is fully effective, would be dedicated to providing a tax cut to those that already have health insurance.

Deduction Would Do Little to Help the Uninsured

The deduction would provide little subsidy to most workers who currently are uninsured and most workers for whom employers pay too little of the premiums to make insurance affordable. Census data show that 93 percent of all uninsured individuals either have incomes too low to incur income tax liability or pay income tax at the 15 percent marginal rate.[1] These

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[1] These data show that 18 million uninsured individuals — 43 percent of all of the non-elderly uninsured — owe no income tax; their earnings are too low for them to incur an income tax liability. These uninsured individuals (continued...)

individuals would at most get a subsidy of 15 percent of the cost of purchasing health insurance, too little to enable most of them to become insured. For low- and moderate-income families and individuals without employer-sponsored coverage, a 15 percent subsidy — which would leave them with the other 85 percent of the premium cost — is too small a subsidy to make insurance affordable.

Rather than helping uninsured workers who cannot afford the premiums required to obtain adequate health coverage, such a deduction would, by and large, provide its principal benefits to individuals in higher tax brackets who already purchase individual insurance. The deduction is worth more than twice as much to individuals in the top tax brackets (the 31 percent, 36 percent, or 39.6 percent brackets) than to moderate- and middle-income families in the 15 percent bracket. Higher-income taxpayers generally can afford insurance without a deduction.

- For a family earning $35,000 whose employer does not offer insurance, the proposed deduction would reduce the cost of a typical family health insurance policy from $7,350 to $6,250, or from 21 percent of income to 18 percent of income.[2]

- Few families that have forgone health coverage because they cannot afford to spend 21 percent of income on it would find coverage affordable because a tax deduction had lowered its cost to 18 percent of income. It may be noted that the child health block grant established in 1997 set a limit on the premiums and co-payments that can be charged under programs receiving block grant funds, with the limit being *five* percent of income for families above 150 percent of the poverty line and smaller amounts for poorer families.

This provision might be of modest help to some moderate-income families whose employer pays half or nearly half of the premium costs, since the deduction would be in addition to the employer subsidy. Even families whose employers pay 50 percent of the premium, however, would receive only very modest help from the deduction. The deduction would reduce

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[1] (...continued)
would receive no benefit from a tax deduction. Another 20 million uninsured individuals — 50 percent of the non-elderly people without health insurance — pay income tax at a 15 percent marginal tax rate. A deduction would provide these taxpayers with a subsidy equal to 15 percent of the cost of insurance not covered by an employer. General Accounting Office, Letter to The Honorable Daniel Patrick Moynihan, June 10, 1998, GAO/HEHS-98-190R, Enclosure II. The analysis is based on the 1996 Current Population Survey. No similar analysis based on more recent CPS data is available.

[2] A General Accounting Office study found that in 1998, health insurance premiums for family coverage purchased in the individual, non-group market range from $3,180 to $14,233 per year, depending on factors such as age, health status, and region of the country. The GAO identifies a "medium" premium cost for a family of four as $7,352. U.S. General Accounting Office, *Private Health Insurance: Potential Tax Benefit of a Health Insurance Deduction Proposed in H.R. 2990* (GAO/HEHS-00-104R), April 21, 2000. It should be noted that in addition to premium costs, health insurance policies typically have substantial deductibles and copayments.

the proportion of the premium these families must pay from 50 percent of the premium to 42.5 percent. While that might help some families afford insurance, the number of such families likely would be small.

In addition, the deduction could induce some employers currently paying more than 50 percent of premium costs to scale back their contribution to 50 percent or less.

Deduction Could Cause Some Erosion in Employer-Based Coverage

While few low- and moderate-income workers would benefit, some could be harmed by the proposal. The proposed new health insurance deduction would allow small business owners or more highly-paid employees to purchase insurance for themselves, using the more generous subsidy the deduction provides for those in higher tax brackets, without the necessity of providing coverage for lower-paid employees. As a result, the deduction could provide an incentive for some small business employers to drop group coverage, or for some owners newly launching small businesses to decline to offer such coverage. To the extent this occurs, it would adversely affect some of the same workers whom the minimum-wage legislation is supposed to help.

FamilyCare Plan

Proposals such as the FamilyCare plan that was included in legislation recently introduced in both the House and the Senate (and drew support from a majority of Senators in a recent vote[3]) — and also is part of the Administration's budget — could expand health care coverage substantially for low-income working parents. The Congressional Budget Office estimates the cost of the Administration's FamilyCare proposal would be $8.7 billion in 2010, compared to the JCT estimate of $10.9 billion in 2010 for the Speaker's proposed tax deduction.

The FamilyCare proposal would provide additional funds to states under the State Children's Health Insurance Program (SCHIP) and allow states to use these funds to extend coverage to the parents of children being insured under Medicaid and SCHIP. Both poor and near-poor families could benefit, with the approach expected to provide insurance ultimately to four million uninsured people, including additional children brought in with their parents, based on Administration estimates. (CBO has not provided estimates of the number of uninsured that would gain coverage under FamilyCare. Although CBO's figure may be lower than the Administration's because CBO estimates a lower cost for the proposal, it would still be substantially higher than the 1.6 million newly insured estimated by JCT for the Speaker's plan.)

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[3] A version of the FamilyCare Act was offered in the Senate as an amendment to the marriage penalty tax bill on July 14, 2000, and secured 51 votes. For procedural reasons, however, the proposal needed 60 of the possible 100 votes to pass.

The FamilyCare Act also contains several smaller provisions that would give states new incentives and options for increasing coverage to children, such as permitting states to use schools and certain other entities to help determine Medicaid eligibility.

New Research Supports the FamilyCare Approach

New research supports the FamilyCare approach of extending health insurance to low-income parents as a way to boost coverage of the uninsured, particularly children. There is widespread agreement on the importance of extending publicly-funded health insurance coverage to low-income children. Although coverage is made available under Medicaid and SCHIP, substantial numbers of eligible children remain uninsured. New research shows that when the parents of these children can be covered under a publicly-funded program, along with their children, participation rates among children are significantly higher.[4]

In addition, in a recent report, the Council of Economic Advisers finds that providing health insurance directly to low-income families through public programs is a much more cost-effective way of expanding coverage than a tax deduction.[5] The report found that a tax deduction for individually purchased health insurance policies, such as Speaker Hastert has proposed, would do little to expand coverage.

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[4] Leighton Ku and Matthew Broaddus, "The Importance of Family-Based Insurance Expansions: New Research Findings about State Health Reforms," Center on Budget and Policy Priorities, September 5, 2000.

[5] The Council of Economic Advisers, "Reaching the Uninsured: Alternative Approaches to Expanding Health Insurance Access," September 2000.