

Health Insurance Exchange Subsidies Create Inequities

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Both the House and Senate versions of the health care bill, as well as the Obama administration's "compromise" proposal, offer large subsidies to encourage low- and middle-income individuals and households to purchase health insurance from private insurers through a government-supervised health insurance exchange.



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The Congressional Budget Office (CBO) estimated that 127 million people potentially qualify for subsidies through the exchange on the basis of their income and family status, but many of them are covered at work or through Medicaid. Therefore, the CBO estimated that only 18 million will participate. However, if the number of people who purchase the subsidized insurance is higher than projected, taxpayer costs will be higher and fewer people will be covered by private employer-sponsored health plans.

Qualifying for a Health Insurance Exchange Subsidy. Because employer-based health insurance is a tax-favored benefit, those who are covered by their company plans will generally be ineligible to buy the exchange-based plans. Premium payments by the employer are not counted as taxable income to the employee and payroll taxes are not imposed on the value. Thus, the employee receives an implicit tax subsidy equal to his or her marginal income tax rate plus the payroll tax rate.

All three versions of the health bill will hold down taxpayer costs for the new program by disqualifying those with employment-based coverage.

However, that means two otherwise identical households with the same total income, number of adults and number of children will face sharply different costs for insurance and health care. [See Figure I.] This violates the tax principle of horizontal equity, which requires that people with equal incomes and similar family circumstances pay equal taxes. The health exchange subsidies also violate the principle of vertical equity because a lower income family covered by an employer's health plan will receive a much smaller subsidy than a higher income family purchasing insurance through the exchange. [See Figure II.]

Low- and middle-income people who buy health exchange policies will receive much larger subsidies than the tax breaks they would receive with employer-provided health insurance. Therefore, people are likely to find ways to qualify for an exchange plan — even if it means leaving a job that provides health insurance. As a result, government cost projections, which do not take into account things such as people intentionally changing jobs, are probably unrealistically low.

Subsidies in the Health Insurance Exchange. The premium subsidies for exchange policies are similar in both the House and Senate bills. They both phase out at about 400 percent of the poverty level. Both bills would also subsidize out-of-pocket costs, such as deductibles and copayments. Costs

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would be lowest for poverty-level households and would rise with income. Under the Senate bill, the copay subsidy phases out for a family at 200 percent of the poverty level, whereas under the House bill it is eliminated for households at 400 percent of poverty.

For example, consider a typical insurance plan with \$15,000 in annual premium costs for a family of four earning \$30,000 annually. Assuming the family is in the 10 percent income tax bracket, the CBO estimates that under the House bill:

- In the exchange, a family of four earning \$30,000 would be charged only \$500 for its health plan, for a federal subsidy of \$14,500.
- A worker with a similar total income (consisting of cash wages plus an employer-provided insurance plan) would receive a tax subsidy of \$2,295, or \$12,205 less than the family in the exchange.

However, the subsidies don't end with premiums. The CBO estimates that, under the House bill, the average cost sharing for a typical policy in the exchange would be \$5,500. But both the House and Senate bills subsidize out-of-pocket costs. For example, take a family earning \$42,000:

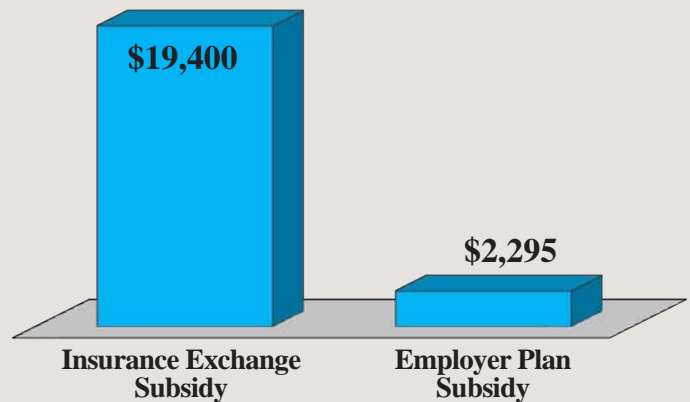
- The House bill would limit the cost of deductibles and copays for an exchange health plan to \$1,200 annually for a family of four earning \$42,000 — a subsidy of \$4,300.
- By contrast, the same family with an employer-provided health insurance plan only receives an income tax break on out-of-pocket medical spending when costs exceed 7.5 percent of adjusted gross income, meaning the tax break would only cover 6 percent of the \$5,500 in average expected cost sharing.
- Adding the subsidies for premiums and cost sharing, the family getting the health exchange policy would receive a total subsidy of \$17,400, while the family receiving employer-based insurance would receive a total subsidy of \$4,143.

It should be noted that in most states the lowest income families might be eligible for Medicaid, which would pay nearly 100 percent of the cost of medical care. Families eligible for Medicaid would be required to enroll in that program instead of purchasing insurance through the exchange.

Conclusion: The Exchange Would Attract Families that Qualify for Subsidies. At lower income levels, the generous subsidies in the House health bill outstrip the tax break on employer-provided plans. For that reason, the bill places restrictions on switching from employer plans to the health exchange programs. With such large differences in subsidies, however, people are bound to find ways to switch over, even if it means changing jobs. This awkward arrangement probably means that the official cost estimate for the bill is unrealistically low.

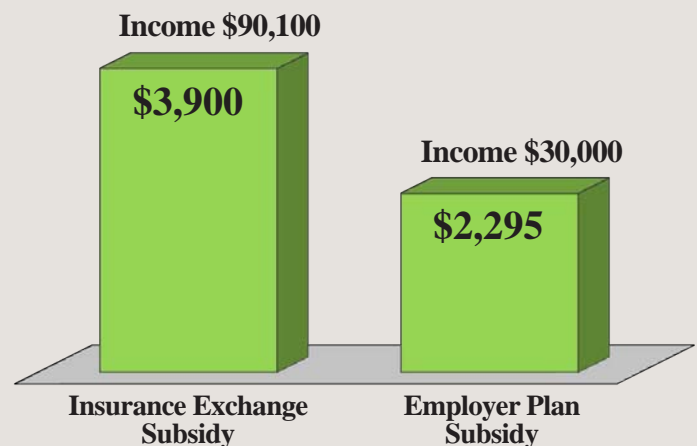
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Figure I
Subsidies for \$30,000-Income Families
(House Bill)



Note: Assumes premium cost of \$15,000, average cost-sharing of \$5,500 for a family of four with stated adjusted gross income.
Source: CBO estimates for a "Silver" health insurance plan and author's calculations.

Figure II
Subsidies for Higher Income and Lower Income Families
(House Bill)



Note: Assumes premium cost of \$15,000, average cost-sharing of \$5,500 for a family of four with stated adjusted gross income.
Source: CBO estimates for a "Silver" health insurance plan and author's calculations.