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# The Bush Health Agenda — Part II: Tax Credits for the Uninsured

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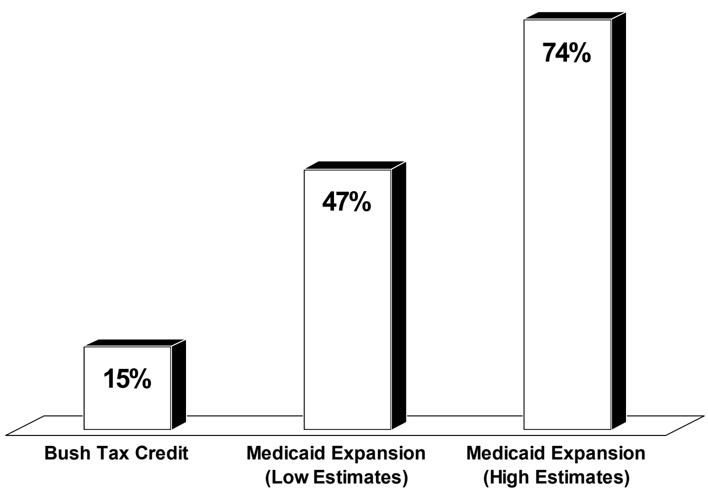
Current federal law includes a number of tax incentives that encourage Americans to obtain health insurance. Employer-provided health insurance and employer reimbursements for medical care are generally excluded from an employee's taxable income. Active employees participating in a cafeteria plan can also pay their share of premiums and medical expenses with pre-tax dollars. Self-employed individuals who are not eligible for subsidized employer coverage can deduct 70 percent of their health insurance premiums in 2002 and 100 percent in 2003.

However, millions of Americans without access to these incentives have no health insurance coverage. The refundable credit President Bush has proposed would help them purchase health insurance. The president's proposal contains a number of important and innovative features.

**Crowd Out: Percent of New Coverage That is Offset by a Decline in Employer Coverage**




Source: David M. Cutler and Jonathan Gruber "Does Public Insurance Crowd Out Private Insurance?," *Quarterly Journal of Economics*, Vol. 111, No. 2, May 1996, pp. 391-430.

**The Credit Varies by Family Income and Size.** The credit would provide a subsidy of up to 90 percent of the cost of health insurance premiums. The maximum credit would be $1,000 per adult and $500 per child for up to two children for a maximum family credit of $3,000. The maximum 90 percent subsidy available to low-income taxpayers would be phased down at higher income levels.

**The Credit Is Refundable.** Even those who owe no income tax would receive the credit by filing an income tax return and claiming a refund against their health insurance expenses. Alternatively, they could get the credit at the time they purchase insurance. The credit would help families who prefer the innovation and flexibility of private insurance to such public insurance as Medicaid and would enable everyone in the family to enroll in the same health care plan.

**The Credit Is "Advanceable."** The credit would be available when the individual or family seeks health insurance. That is, any person eligible for the credit could receive it in advance, before filing that year's tax return, to reduce the monthly insurance premium payment. Further, eligibility for the advance credit would be based on the individual's prior-year income. Earning more during the current year would not reduce the value of the credit, and no end-of-year reconciliation would be required.

**The Credit Is Flexible.** Many states have set up purchasing groups that allow families eligible for the State Children's Health Insurance Plan (SCHIP) to choose among private insurance plans. The president's proposal would permit certain low-income individuals to purchase private insurance for themselves and their families through state-sponsored health insurance purchasing groups or high-risk pools. This would expand coverage options, introduce economies of scale and encourage risk pooling among those unable to get coverage through an employer.

**The Credit Could Be Supplemented with State Funds.** States could make an additional contribution

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to individuals who claim the credit in connection with purchases of private insurance through Medicaid, SCHIP or other state-sponsored purchasing groups. The maximum additional state contribution would be $2,000 per adult for up to two adults for families with incomes up to 133 percent of the poverty line.

**The Credit Is Generous.** Recent research suggests that the credit would provide good, affordable health insurance options for most eligible individuals. A detailed state-by-state analysis by the Council of Economic Advisers found that for most lower-income Americans the proposed health insurance credit would cover more than half of the premium, and for most others more than a third. (The study is available at http://www.whitehouse.gov/cea/HealthCredit_Feb02wp.pdf)

A 2002 report sponsored by the Kaiser Family Foundation, as well as other studies of hypothetical insurance purchasers, claimed that those with chronic health conditions could not obtain reasonably priced comprehensive health insurance in the non-group market. However, the National Association of Health Underwriters examined the Kaiser study and found that virtually all of the hypothetical applicants could obtain at least one good policy. The one applicant who generally could not get an insurance offer (a person who was HIV positive) could have obtained subsidized insurance through high-risk pools available in 30 states. Adequately funded high-risk pools have been shown to help all persons in a state get good coverage. Indeed, states like New Hampshire that previously tried and failed to provide affordable coverage by imposing strict rating restrictions are now turning to high-risk pools.

**Expected Impact.** According to estimates by the Treasury Department's professional staff, approximately 17 million Americans would take up the president's proposed tax credit. This total includes 6 million Americans who would otherwise have been uninsured for some or all of a year. It also includes more than 8 million Americans who would otherwise have had less adequate non-employer insurance. And the comprehensive Treasury analysis showed that only 15 percent of those taking up the credit would otherwise have obtained employer coverage.

**Effect on Employer Coverage.** Some have suggested that if the purchase of health insurance outside the employer market becomes sufficiently attractive, employers might stop providing health insurance coverage to their workers. The president's proposal was carefully designed to minimize "crowd out" of subsidized employer coverage and to substantially expand coverage.

Several elements of the credit design contribute to this desirable result. Most importantly, low-income individuals and families who are least likely to have employer-based health insurance would receive the largest incentives. In addition, the health credit subsidy would decrease as income increases, so it would become less and less attractive as income levels rise.

Those low-income Americans who would be eligible for the largest credit are the least likely to have employer-sponsored health insurance. Around 80 percent of uninsured workers are not offered health insurance by their employers. Only 36 percent of people under age 65 with incomes below 200 percent of the federal poverty line have employer-sponsored health insurance, while 81 percent of those above do. Tax benefits for employer coverage would remain large for the middle- and higher-income workers with access to generous employer-sponsored plans, so employer-provided coverage would remain attractive for firms that offer generous coverage today.

The rate at which the president's proposed tax credit would "crowd out" employer plans compares favorably to alternative proposals. Any proposal that expands alternatives to employer coverage, including expansions of Medicaid or SCHIP eligibility, risks some crowd out. For example, a study by Professors David Cutler and Jonathan Gruber in the *Quarterly Journal of Economics* found that 50 to 75 percent of the "new" coverage resulting from Medicaid expansions in the early 1990s was offset by a reduction in employer coverage. [See the figure.]

See also The Bush Health Agenda — Part One: Strengthening Employer-Sponsored Coverage.

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