WebMemo
Published by The Heritage Foundation
No. 1711
November 28, 2007

Health Care Tax Credits: The Best Way to Advance Affordability, Choice, and Coverage

Greg D'Angelo

There is broad agreement that health care tax credits could remove the inequities in the current tax treatment of health insurance. But they are also a good mechanism to improve affordability of health plans and thus reduce the number of the uninsured, particularly among lower-income individuals and families. As Jonathan Gruber of the Massachusetts Institute of Technology and Leonard Burman of the Urban Institute have noted, "tax subsidies appear [to be] the only game in town for expanding the federal role in the provision of health insurance."[1]

The right policy for Congress is to expand access to private insurance for the uninsured through direct tax relief. Health care tax credits coupled with other state reforms would go a long way toward improving affordability and reducing the ranks of the uninsured.

Critics Are Missing the Point. While there is a growing policy consensus on the value of tax credits to reduce the number of the uninsured, the approach has some prominent critics. These critics contend that tax credits: (1) are not as generous as "free" public programs; (2) do not sufficiently address the issue of affordability in health care; (3) would result in individuals and families choosing health plans different from employer-provided or government-controlled coverage; and (4) would not reduce the ranks of the uninsured.

However, the critics miss a number of crucial points.

The Myth of "Free" Health Care. Federal policymakers interested in reducing the ranks of the uninsured, particularly among lower-income individuals and families, have two options: expand public programs or provide direct tax relief to individuals and families through a refundable tax credit.

No responsible public official is suggesting that the Treasury should cover the entire cost of health care for all individuals and families through a tax credit. Likewise, the expansion of "free"[2] public programs would come at considerable cost to taxpayers and, in many different ways, to patients.

Public programs do not solve the problem of access to health care. According to Jonathan Gruber of MIT and Kosali Simon of Cornell University, public programs might offer "the best insurance money can't buy" because of the supposed comprehensiveness of the government coverage yet widely known reality that patients have "trouble availing themselves of that coverage because physicians do not want to accept them" as a result of reimbursements being set significantly lower than in the private sector.[3]

Gruber and Simon highlight one study that found "one-third of all physicians reported that they serve no Medicaid patients, and another third reported that they limit access of Medicaid patients to their practice."[4]

This paper, in its entirety, can be found at: *www.heritage.org/Research/HealthCare/wm1711.cfm*

Produced by the Center for Health Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

The Heritage Foundation
LEADERSHIP FOR AMERICA

Affordability Issue Is Not Exclusive to Tax Credits. Although some argue that tax credits do not make health care sufficiently affordable,[5] the question of what constitutes "affordable" in health care is largely subjective and not an issue exclusive to the use of tax credits. The issue of affordability is often a matter of how much the government would spend, not whether the expenditure should be made through public programs or the private sector.

It is virtually impossible to define affordability for individuals and families with different means and varying needs and preferences. Studies have used many techniques and definitions to estimate how affordable insurance is.[6] In fact, according to a recent study by M. Kate Bundorf of Stanford University and Mark V. Pauly of the University of Pennsylvania's Wharton School, "…health insurance was affordable to between one-quarter and three-quarters of the uninsured."[7]

Even if health insurance is already affordable to many of the uninsured, tax credits would help make it more affordable for many others. But federal health care tax credits alone, depending on how they are designed, might not fully address the problem of affordability for the poorest among the uninsured. In certain cases, depending on income or health care needs, coverage could be enhanced through different streams of state funding.

Nonetheless, a large part of the problem can be mitigated by offsetting the massive tax penalty individuals and families face if they receive health insurance outside of the place of work. Short of fully addressing this inequity in the tax code, a tax credit—instead of covering the full cost of health insurance—could level the playing field by offering a comparable tax break for those who do not fit into today's system centered on employers and government.

In any case, affordability is not just an issue for tax credits but also an issue for public program expansion. The key point is that tax credits can make coverage more affordable for millions of Americans. The impact will depend on the design and generosity of the credit itself, a prudential matter for policymakers.

Choice of Health Plans Will Control Costs. Today, employers and government officials, not individuals, make the key health care decisions—particularly what is, or is not, covered in health plans. Few individuals and families actually select the health insurance that best meets their personal needs and preferences. So, health plans respond

1. Leonard E. Burman and Jonathan Gruber, "Tax Credits for Health Insurance," Urban–Brookings Tax Policy Center, *Tax Policy Issues and Options* No. 11, June 2005, p. 1, at *www.urban.org/UploadedPDF/311189_IssuesOptions_11.pdf*.
2. See Centers for Medicare and Medicaid Services, State Children's Health Insurance Program Summary, at *www.cms.hhs.gov/MedicaidGenInfo/05_SCHIP%20Information.asp*. For instance, current law allows states to require cost sharing for up to 5 percent of a family's income for SCHIP beneficiaries. However, few states require meaningful cost sharing. States that do require cost sharing often require families to pay far less than 5 percent of their income. For example, in New Jersey, a family of four earning 200 percent of the FPL could receive coverage for 1.8 percent of the family's income with minimal copayment requirements. For an explanation, see NJ FamilyCare, "What it Costs," at *www.njfamilycare.org/pages/whatItCosts.html*.
3. Jonathan Gruber and Kosali Simon, "Crowd-Out Ten Years Later: Have Recent Public Insurance Expansions Crowded Out Private Health Insurance?" National Bureau of Economic Research, *Working Paper* No. 12858, p. 5, at *www.nber.org/papers/w12858*.
4. *Ibid.*
5. Edwin Park , *et al*., "Martinez Bill Would Weaken Children's Health Coverage: Bill Would Lead to Cuts in SCHIP While Creating Poorly Designed Tax Credit," November 5, 2007, at *www.cbpp.org/11-5-07health.htm*; Linda J. Blumberg and Genevieve M. Kenney, "Can a Child Health Insurance Tax Credit Serve as an Effective Substitute for SCHIP Expansion?" *Healthy Policy Online*, No. 17, October 2007, at *www.urban.org/publications/411560.html*.
6. For a discussion of affordability standards, see Linda J. Blumberg, *et al*., "Setting A Standard Of Affordability For Health Insurance Coverage," *Health Affairs*, 26, no. 4 (2007): w463–w473, at *http://content.healthaffairs.org/cgi/content/abstract/26/4/w463*.
7. M. Kate Bundorf, *et al*., "Is health insurance affordable for the uninsured?" *Journal of Health Economics*, 25 (2006) 650–673.

directly to employers and government officials, and they do not need to directly compete for consumers' dollars. Therefore, they often have no compelling economic incentive to provide value to the patient for the money the patient spends either through an employer premium or a tax bill.

If the federal tax code were changed to provide direct tax relief to individuals and families, they would have the ability to select the health insurance that they want and need—whether obtained through their employer or a different organization. More patients would become price-sensitive, and health plans would be incentivized to provide value for money. Employers and government officials are no substitute for individuals when it comes to making health care decisions. Patients can make decisions that reflect their true preferences and optimize their utility. Therefore, tax credits would facilitate the creation of a patient-centered system of personal choice and value-based competition. This would introduce a new economic efficiency into the system and thus control costs in a rational fashion.[8]

Reduce the Number of the Uninsured. Over the years, health care tax credits have gained broader support from a bipartisan group of policymakers. There is ongoing debate on legislation to reauthorize the State Children's Health Insurance Program (SCHIP), which centers on whether to expand eligibility into the middle class—from 200 percent to 300 percent of the federal poverty level (FPL). Meanwhile, two like-minded tax credit alternatives have been advanced. In May, Rep. Rahm Emanuel (D–IL) introduced the Healthy Kids Act of 2007 (H.R. 2147). The bill provides that families with children earning between 200 percent and 300 percent of the FPL receive tax relief to obtain private insurance, paying for part of its cost. Families would get a progressive tax credit worth 55 percent to 75 percent of the insurance premium; families would pay the other 25 percent to 45 percent directly.

In October 2007, Senators Mel Martinez (R–FL) and George Voinovich (R–OH) and Representatives Marilyn Musgrave (R–CO), Tom Price (R–GA), Tom Feeney (R–FL), and Tim Walberg (R–MI) introduced the More Children, More Choices Act of 2007 (S. 2193, H.R. 3888). The bill would provide a tax credit worth up to $1,400 per child for the families in the income range of 200 percent to 300 percent of the FPL.

As a matter of policy, this type of approach could significantly reduce the number of the uninsured. Preliminary estimates by the Lewin Group show that a child health care tax credit, similar to that envisioned in the Martinez–Musgrave bill, can insure nearly all children between 200 percent and 300 percent of the FPL.[9] However, much depends on the design of the credit, which is a matter of detailed legislative negotiation. Congress would have to choose between a flat credit, a progressive credit, or some combination of both to maximize coverage.

Additional Measures to Boost the Tax Credit. While health care tax credits would make health care more affordable, give patients more choices, and reduce the number of uninsured, alone they cannot solve the problem of health care coverage in its entirety. Any approach to helping the uninsured needs to be coupled with other state reforms to address local concerns.[10] For instance, a child health care tax credit, as envisioned in the More Children, More Choices Act of 2007, could be coupled with innovative state reform initiatives to optimize functioning of the credit. State officials would have both the incentive and the ability to supplement the credit to improve affordability or implement statewide private risk-transfer mechanisms to cope with adverse selection and high-cost enrollees. States could also

8. For more information, see Nina Owcharenko, "Health Care Tax Credits: Designing an Alternative to Employer-Based Coverage" Heritage Foundation *Backgrounder* No. 1895, November 8, 2005, at *www.heritage.org/Research/HealthCare/bg1895.cfm.*
9. Estimates for coverage levels in 2009 by Lewin Group were based on a Heritage proposal for a health care tax credit to be applied to families with children in the income range of 200 percent to 300 percent of the FPL.
10. Sherry Glied and Douglas Gould, "Variations In the Impact of Health Coverage Expansion Proposals Across States," *Health Affairs*, June 7, 2005 W5-259.

establish new pooling arrangements, such as statewide health insurance exchanges, to expand affordability and portability of coverage.

Conclusion. Affordability remains an issue whether expanding coverage through government programs or through a health care tax credit.

Congressional provision of health care tax credits would go a long way toward making health insurance more affordable and reducing the number of the uninsured. But, as with any approach, health care tax credits are not a complete solution to the complex problem of the uninsured. While credits can reduce cost and expand access to care, they can and should be combined with other measures—most importantly, reforms of health insurance markets at the state level.

—Greg D'Angelo is Research Assistant in the Center for Health Policy Studies at The Heritage Foundation.

The Heritage Foundation
LEADERSHIP FOR AMERICA