Can the President's Health Care Tax Proposal Serve as an Effective Substitute for SCHIP Expansion?

Timely Analysis of Immediate Health Policy Issues
October 2007

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Summary

The Bush administration has proposed using the tax system to subsidize the purchase of health insurance, suggesting that offering parents tax deductions to offset the costs of insurance—rather than expanding the State Children's Health Insurance Program (SCHIP)—would be an effective way to extend coverage to more children. This brief compares the financial burden that parents would incur in obtaining coverage for their children under the president's tax-deduction proposal against that associated with SCHIP. It finds that the financial burdens for families between 150 and 300 percent of the federal poverty level (FPL) would be much higher under the tax-deduction approach than under SCHIP. Even after receiving the proposed tax subsidies under the president's proposal, a two-parent family with two children earning approximately $32,000 per year would pay 39 percent of their income to obtain private nongroup coverage for their children with comparable benefits to that provided through SCHIP at no cost to the family. Under the president's proposal, a two-parent/two-child family earning approximately $54,000 per year would still spend more than a fifth of their income on private nongroup health insurance to obtain comparable benefits to what they could obtain for their children under SCHIP for 1 percent of their income. The financial burden for single-parent families with one child are even greater under the tax proposal. Therefore, the potential to decrease the number of uninsured children would be substantially greater under an SCHIP expansion than under proposed tax deductions.

Background

Congress and the Bush administration are currently at odds over the reauthorization of the State Children's Health Insurance Program (SCHIP). In early October, the president vetoed the bill Congress passed that would have provided sufficient funding to maintain current levels of public coverage for children, cover more uninsured children who are currently eligible for Medicaid and SCHIP but are not yet enrolled, and cover additional children who would become eligible for coverage as a result of eligibility expansions.[1]

Last February, the Bush administration proposed using the tax system to subsidize the purchase of health insurance. The administration has suggested that this approach is preferable to expanding coverage for children through SCHIP, preferring to preserve public programs for only the lowest-income children.[2] The president's tax proposal would eliminate the current tax exemption for employer contributions to health insurance and replace it with a new standard deduction for individuals and families purchasing health insurance. The approach would eliminate the current tax preference for employer-based insurance, since the deduction would apply regardless of whether coverage was purchased through an employer or directly through the nongroup insurance market. The deduction would also decrease any current incentives to purchase overly comprehensive insurance policies, as the value of the deduction would not vary with the premium. The deduction would be set at $15,000 for family policies, and that amount would grow with the consumer price index. As is the case with the current tax exemption, the tax savings associated with this deduction increases the higher the family's income and marginal tax rate.[3] An inherent difficulty in relying upon the president's proposal for expanding health insurance coverage specifically for children is that it was not designed to subsidize the purchase of coverage for children only. As a consequence, to obtain new coverage for children, a tax-paying adult in the family must also obtain coverage, thereby increasing the implicit cost associated with insuring children.[4]

In contrast, SCHIP uses a combination of state and federal funding to provide health insurance specifically to children, most of whom live in families with incomes below 200 percent of the Federal Poverty Level (FPL).[5] The vast majority of SCHIP enrollees receive coverage through private health insurance plans that contract to provide such services with the state in which the child resides.[6] While the federal government does not require a particular benefit package be offered, benefits must be consistent with designated benchmarks within the state, and these benchmarks are made up of comprehensive employer-based plans.[7] However, cost-sharing requirements under SCHIP are lower than under typical employer-based plans. SCHIP provides a number of limits on cost-sharing that can be imposed, including that cost-sharing may not exceed 5 percent of a family's income. Additional protections are in place to reduce the

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chance a child might be disenrolled from the program due to premium nonpayment.[8]

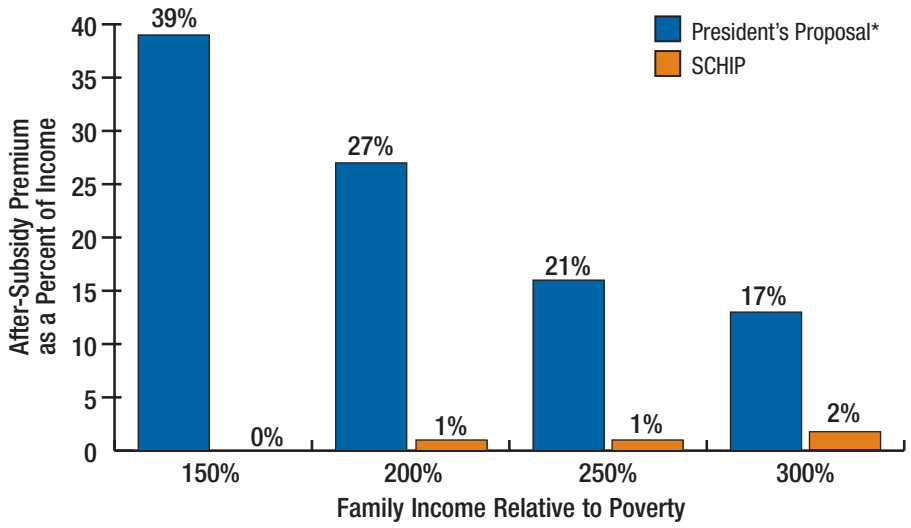
The purpose of this brief is to compare the family financial burdens associated with covering children and to assess the potential for expanding health insurance coverage for children between 150 and 300 percent of the FPL under the president's proposal and under SCHIP.[9]

Data and Methods

We compare the typical price of health insurance coverage relative to family income for children in the 150 to 300 percent of the FPL income range under the president's health insurance tax deduction proposal and under SCHIP. We focus on this income group because it contains a large share of uninsured children and because many SCHIP enrollees are in this income group. However, 92 percent of children currently enrolled in SCHIP are in families with income below 200 percent of the FPL,[10] and 75 percent of the uninsured children who are eligible for SCHIP but not enrolled fall into this low-income group as well.[11] It is also critical to remember that the majority of children who are currently uninsured but eligible for public insurance are eligible for Medicaid, not SCHIP,[12] and these children come from families with even lower incomes than the children analyzed here. While the congressional bill includes funding and policy changes aimed at increasing enrollment of these children in Medicaid at little or no cost to the families, families in this income bracket would receive little to no subsidy from the administration's tax-based approach.

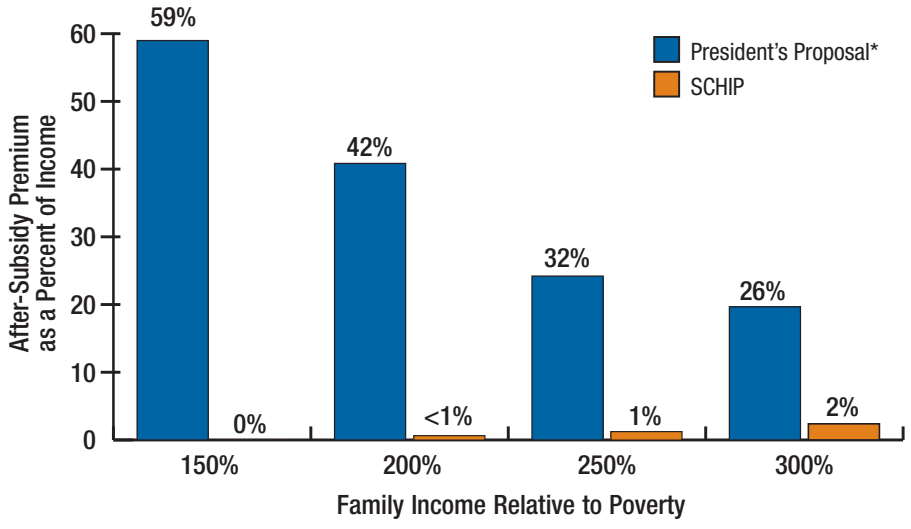
We analyze the family's cost of obtaining insurance coverage for their uninsured children under each policy option for two prototypical families—a single parent with one child and two parents with two children—at four different income levels relative to poverty (150, 200, 250, and 300 percent). We calculate the costs under the administration's proposal in two ways: first, assuming the family buys coverage through the private nongroup market, and second, assuming the coverage comes through the

FIGURE 1: Financial Burden of Providing Nongroup Health Insurance to Children Under the Bush Tax Plan and Under SCHIP: Prototypical Two-Parent/Two-Child Families, 2009



**Note*: 80% of uninsured children in this income range have no parent with employer-based coverage, making the nongroup market their most likely insurance source under the president's plan. Estimates reflect the cost of obtaining family coverage, since the proposal is not designed to subsidize the purchase of coverage for children only.
Source: Author's calculations based upon current and proposed tax law and source material based upon Kenney, Hadley, Blavin 2007.

FIGURE 2: Financial Burden of Providing Nongroup Health Insurance to Children Under the Bush Tax Plan and Under SCHIP: Prototypical One-Parent/One-Child Families, 2009



**Note*: 80% of uninsured children in this income range have no parent with employer-based coverage, making the nongroup market their most likely insurance source under the president's plan. Estimates reflect the cost of obtaining family coverage, since the proposal is not designed to subsidize the purchase of coverage for children only.
Source: Author's calculations based upon current and proposed tax law and source material based upon Kenney, Hadley, Blavin 2007.

employer. We then calculate the family cost associated with covering children under the SCHIP program.

Because 79 percent of uninsured children between 150 and 300 percent of the FPL do not have even one parent with private health insurance coverage,[13] providing coverage to children under the administration's proposal would usually require the purchase of a new family policy, not merely a change from adult-only coverage to family coverage. Coverage for all family members comes with the higher costs of purchasing a private family policy under the administration's proposal, whereas SCHIP coverage would typically only insure the children, thereby keeping the cost down for insuring them specifically.

In the private nongroup market case, we assume that family members are of average age and health status, such that they would be able to purchase coverage consistent with a typical employer-based policy at an average price in the small employer group market. We rely on national average premiums in the small group market[14] to provide a basis for a consistent comparison with the benefit packages provided under SCHIP, which are based on typical employer-based insurance policies in the state. To analyze the proposals in 2009 dollars, average premiums obtained from the 2005 Medical Expenditure Panel Survey Insurance Component (MEPS-IC) are increased by the predicted rate of growth in private health insurance premiums.[15]

Consequently, in this simple analysis, we do not address the difficulties inherent in the private nongroup insurance markets of most states, where people with current or past health problems may be unable to purchase a policy at any price, or may face premiums much higher than those used in this analysis, or may only be offered benefit packages that permanently exclude services for particular health care needs. We also have not increased premiums relative to employer averages to account for the higher administrative loads implicit in nongroup premiums relative to those in the small group market. Lack of guaranteed access to adequate coverage through the current nongroup market is, however, a critical issue that should be considered when evaluating the president's proposal. Additionally, equalizing the tax subsidy for health insurance in the group and nongroup markets decreases incentives for employers to offer health insurance to their workers. This change may lead some employers to drop their coverage, leaving more families to purchase coverage in the nongroup market, a situation that could make many currently insured people worse off, particularly those with high health care needs. Again, this brief does not account for such an impact.

In the group market case, we again use national average employer premiums (from the 2005 MEPS-IC) increased by the predicted rate of growth in private health insurance premiums to 2009 levels. Unlike the situation with nongroup insurance, the current tax code already provides a subsidy for the purchase of employer-based insurance. For uninsured families with access to employer insurance, the current subsidy is an insufficient incentive to enroll. Consequently, when analyzing the president's proposal and its potential for increasing the coverage of children in the group market, the measure of key interest is the *difference* between the current and proposed tax subsidies. If the proposed subsidy is significantly larger relative to family income or relative to the full premium than the current subsidy, it might be expected to have a significant impact on coverage decisions. But if the difference is small, one would not expect it to induce a significant change in coverage decisions.

The individual income tax liability for each prototypical family is determined using a simplified tax calculator that assumes wages are the only source of income; the family takes only the standard deduction and the proposed standard deduction for health insurance; children are eligible for both the child tax credit (CTC) and the earned income tax credit (EITC); and the family claims no credits other than the CTC and EITC. The calculator includes the impact of the alternative minimum tax (AMT) and assumes the only AMT preference items are the standard deduction and personal exemptions. The values of parameters used to calculate taxes in 2009 are based on the January 2006 inflation forecast from the Congressional Budget Office.

The reduction in tax liability under the administration's proposal would occur through reductions in income taxes and payroll taxes; at lower incomes, the payroll tax reduction makes up the largest share of the tax savings. As Burman et al note, counting the full amount of the payroll tax reduction as a subsidy would be inappropriate, since such current "savings" would be largely, if not completely, offset by future reductions in social security benefits, particularly for the low-income.[16] In essence, low-income workers would be paying for today's tax subsidy with forgone future social security payments since the less they pay into the system today, the less the system pays out to them upon retirement. Consequently, the results shown here exclude the payroll tax reductions from the subsidy calculations under the administration's proposal as well as in the calculation of the tax liability under current law. (Calculations including the payroll tax reductions are available upon request from the author.)

SCHIP premiums used here for children of different income levels are the medians of the range of premiums that states charged families in 2007.[17] No analysis documents the rate of growth in SCHIP premiums; consequently, we inflated the premiums to 2009 using the projected growth rates in private health insurance premiums. This likely biases future SCHIP premiums upward, as many states have gone several years without changing these premiums.

Findings

Table 1 provides estimates of the impact of the administration's proposed health insurance tax subsidy on the cost of family coverage for two-parent/two-child families and one-parent/one-child families in the private

nongroup market. As the first section of the table shows, even after the tax subsidy is taken into account, purchasing family health insurance coverage that would include insurance for both children would cost a typical two-parent/two-child family at 150 percent of the FPL 39 percent of their family income in 2009, with the subsidy only covering 5 percent of the premium cost. For those at 300 percent of the FPL, with the tax subsidy, the cost of coverage to the family constitutes 17 percent of income, with the subsidy covering 17 percent of the full premium. In later years, the financial burdens would increase for all income groups, as the deduction is not designed to increase at the same rate as health insurance premiums.

For the single-parent families analyzed in the bottom section of Table 1, the financial burden of purchasing coverage for their children is even greater. Purchasing a family insurance policy in the private nongroup market with benefits comparable to those that the child would receive under SCHIP would cost a family at 150 percent of the FPL 59 percent of family income, with the subsidy covering 5 percent of the full premium. For a typical family at 300 percent of the FPL, purchase of the insurance policy would cost 26 percent of income in 2009 (a premium subsidy of 17 percent). Notable across both sections of the table is how the value of the subsidy is lowest for those at the bottom of the income range and increases with income, which runs counter to the purpose of a subsidy designed to provide greatest support to the most economically vulnerable.

Some families might be able to purchase coverage at a lower price if the coverage excluded certain benefits typically considered part of comprehensive insurance policies, or if they chose policies with significantly higher deductibles and/or cost-sharing requirements than are typical under SCHIP. However, the greater the out-of-pocket requirements imposed, the greater the difficulty low-income parents face when attempting to access necessary care for their children and the greater their consequent out-of-pocket spending burdens.[18]

In the past, the administration has proposed using refundable tax credits as opposed to a new standard tax deduction to lower the cost of private nongroup insurance coverage for the

TABLE 1: Impact of President's Health Care Tax Proposal on the Price of Family Health Insurance in the Private Nongroup Market By Family Income Relative to Poverty, 2009

Two-Parent Family with Two Children				
Income as Percent of the Federal Poverty Level	150%	200%	250%	300%
Family Income	32,379	43,137	53,895	64,654
Subsidy for Health Insurance	698	1,569	2,107	2,289
Subsidy as Percent of Premium	5%	12%	16%	17%
After-Subsidy Premium as Percent of Income	39%	27%	21%	17%
Single-Parent Family with One Child				
Income as Percent of the Federal Poverty Level	150%	200%	250%	300%
Family Income	21,412	28,201	35,512	42,824
Subsidy for Health Insurance	611	1,353	1,928	2,250
Subsidy as Percent of Premium	5%	10%	15%	17%
After-Subsidy Premium as Percent of Income	59%	42%	32%	26%

Source: Urban Institute analysis of prototypical families, based upon current and proposed tax law. See data and methods section of text for further detail on income tax calculations.
Notes: Calculations of the subsidies do not include payroll tax reductions under the proposal as these reductions would largely be paid back by future reductions in Social Security benefits. Results including payroll tax reductions can be obtained upon request of the author. The average family premium in 2009 is $13,206.

TABLE 2: Difference Between President's Health Care Tax Proposal and Current Law Tax Subsidies for Family Health Insurance in the Private Employer Group Market By Family Income Relative to Poverty, 2009

Two-Parent Family with Two Children				
Income as Percent of the Federal Poverty Level	150%	200%	250%	300%
Family Income	32,379	43,137	53,895	64,654
Current Subsidy for Health Insurance	3,644	1,981	2,290	3,434
Proposed Subsidy for Health Insurance	1,692	2,230	2,559	3,742
Difference between Current and Proposed	-1,952	249	269	308
Difference as Percent of Premium	-15%	2%	2%	2%
Difference as Percent of Income	-6%	1%	<1%	<1%
Single-Parent Family with One Child				
Income as Percent of the Federal Poverty Level	150%	200%	250%	300%
Family Income	21,412	28,201	35,512	42,824
Current Subsidy for Health Insurance	3,814	3,021	1,981	2,247
Proposed Subsidy for Health Insurance	1,883	2,230	2,250	2,516
Difference between Current and Proposed	-1,931	-791	269	269
Difference as Percent of Premium	-15%	-6%	2%	2%
Difference as Percent of Income	-9%	-3%	1%	1%

Source: Urban Institute analysis of prototypical families, based upon current and proposed tax law. See data and methods section of text for further detail on income tax calculations.
Notes: Calculations of the subsidies do not include payroll tax reductions under the proposal as these reductions would largely be paid back by future reductions in Social Security benefits. Results including payroll tax reductions can be obtained upon request of the author. The average family premium in 2009 is $13,206. Negative differences between current-law and proposed subsidies indicate that the proposed subsidy is smaller than the current law subsidy for a family at the given income level.

low-income population. But even under such an alternative, the administration has not proposed a subsidy greater than $3,000 for a two-adult/two-child family, which would still leave such a family at 150 percent of the FPL with a premium burden of 32 percent of income. In addition, this option would still require that the shortcomings of the nongroup market be addressed in order to ensure access to adequate coverage.

For the roughly 20 percent of uninsured children in families with incomes between 150 and 300 percent of the FPL where a parent has ESI coverage, we compare the current-law tax subsidy for employer-sponsored insurance payments for family coverage with the subsidy under the administration's proposal. Table 2 shows the results for our prototypical families. Here we see that for the families at the low end of the income range, the subsidy provided under the administration's proposal would be smaller than the current-law subsidy provided by exempting employer-sponsored insurance from tax. This implies that such families would be *less* likely to purchase family coverage under the proposal than they are today. For the higher-income families, the administration's proposed subsidy would be larger than the current subsidy, but the difference is very small, amounting to no more than 2 percent of premium or 1 percent of family income. Such a small increase in the subsidy could not be expected to have a significant impact on the likelihood of purchasing coverage relative to current law.

Table 3 shows the predicted financial burdens associated with SCHIP premiums for the same types of families used in analyzing the president's proposal. The after-subsidy cost of obtaining coverage for children in either the two-parent family or the single-parent family ranges from 0 to 2 percent of income, depending on family income. In contrast to the administration's tax proposal, under SCHIP, financial burdens as a percentage of income are lowest for the lower-income families and highest for the families at 300 percent of FPL.

TABLE 3: The Cost to the Family of Children's Health Insurance Under SCHIP By Family Income Relative to Poverty, 2009

Two-Parent Family with Two Children				
Income as Percent of the Federal Poverty Level	150%	200%	250%	300%
Family Income	32,379	43,137	53,895	64,654
After-Subsidy Premium	0	243	617	1,081
After-Subsidy Premium as Percent of Income	0%	1%	1%	2%
Single-Parent Family with One Child				
Income as Percent of the Federal Poverty Level	150%	200%	250%	300%
Family Income	21,412	28,201	35,512	42,824
After-Subsidy Premium	0	128	405	811
After-Subsidy Premium as Percent of Income	0%	<1%	1%	2%

Notes: After-subsidy premiums are equal to the 2007 unweighted median across 50 states, inflated to 2009 using the projected growth in per capita private health insurance expenditures.
Source: Premium data were obtained from a 2007 update of the data used in Kenney G, Hadley J, and Blavin F, 2007.

Conclusion

The financial burden under SCHIP is therefore substantially lower than under the president's tax proposal, as Figures 1 and 2 illustrate. Both experience and the economic literature are clear that the higher the premium, the lower the voluntary enrollment in insurance will be.[19] Consequently, if each program is evaluated solely on its ability to expand health insurance coverage to children, SCHIP's potential far outpaces that of the Bush administration's proposal on price alone. The differential impact on insurance coverage is especially dramatic when one takes into account that 1.7 million children projected to gain insurance coverage under the SCHIP bill would be covered by Medicaid[20]—most of these children have lower incomes than those analyzed here and would receive little to no subsidy under the president's approach. Add to that the complexities, limitations of access, premium variation, and higher cost-sharing requirements in the private nongroup market, and the investment in outreach and enrollment improvements included in Congress's SCHIP reauthorization bill, and the differences between the two approaches are amplified.

[1] G. Kenney, A. Cook, J. Pelletier, "SCHIP Reauthorization: How Will Low-Income Kids Benefit Under House and Senate Bills?" *Timely Analysis of Immediate Health Policy Issues Series* (Washington, DC: The Urban Institute, 2007), http://www.urban.org/publications/411545.html

[2] See for example, 7/17/07 letter from the U.S. Department of Health and Human Services Secretary Leavitt to Senators Baucus and Grassley and 7/26/07 letter from Secretary Leavitt to Congressman Rangel.

[3] In fact, at the lower income levels, the tax deduction provides value only through the payroll tax element, since those at very low income levels have almost no income tax liability to offset. The proposal also includes a reintroduction of the president's proposal to allow federally licensed association health plans to sell insurance to small employers outside of state health insurance regulations. It also includes a proposal that is not well defined to allow states to redirect funds currently received through the Medicaid Disproportionate Share Hospital program to be used to purchase health insurance coverage for low-income individuals and those with chronic medical conditions; however, there is no requirement for states to do so, and no additional federal funding beyond current levels. These latter two dimensions of the proposal are not assessed here.

[4] There is no indication that the administration anticipated the tax deduction being applied to the purchase of coverage for children only, an insurance option not widely available or subscribed to at the current time. Coverage for the adult taxpayer, at a minimum, is presumed under the approach. U.S. Department of Treasury, "General Explanations of the Administration's Fiscal Year 2008 Revenue Proposals (The Blue Book)" (Washington, DC: U.S. Department of the Treasury, 2007), http://www.treas.gov/offices/tax-policy/library/bluebk07.pdf.

[5] C. Peterson and E. Herz, "Estimates of SCHIP Child Enrollees up to 200% of Poverty, above 200% of Poverty, and of SCHIP Adult Enrollees" (Washington, DC: Congressional Research Service, 2007).

[6] J. Solomon, "The False 'Public versus Private' Choice for Children's Health Coverage" (Washington, DC: Center for Budget and Policy Priorities, 2007), http://www.cbpp.org/6-21-07health.htm.

[7] The three benchmark options are a state employee health plan, the Blue Cross Blue Shield standard option plan offered to federal employees, and the HMO plan with the greatest enrollment in the state. See http://www.cms.hhs.gov/MedicaidGenInfo/05_SCHIP%20Information.asp.

[8] http://www.cms.hhs.gov/MedicaidGenInfo/05_SCHIP%20Information.asp.

[9] While the president's proposal has a scope well beyond expanding coverage for children, we do not assess its impacts in other areas. Such comprehensive analyses of the president's proposal have been done by others (see L. Burman, J. Furman, and R. Williams, "The President's Health Insurance Proposal—A First Look" [Washington, DC: Urban Institute–Brookings Institution Tax Policy Center, 2007).

[10] See Peterson and Herz, "Estimates of SCHIP Child Enrollees up to 200% of Poverty, above 200% of Poverty, and of SCHIP Adult Enrollees."

[11] G. Kenney, A. Cook, and J. Pelletier, "SCHIP Reauthorization: How Will Low-Income Kids Benefit under House and Senate Bills?"

[12] Congressional Budget Office, "Cost Estimate for H.R. 976, Children's Health Insurance Program Reauthorization Act of 2007" (Washington, DC: Congressional Budget Office, 2007), available at http://www.cbo.gov.

[13] Urban Institute tabulations of the 2006 ASEC Supplement to the Current Population Survey.

[14] Agency for Healthcare Research and Quality, Center for Financing, Access and Cost Trends, 2005 Medical Expenditure Panel Survey-Insurance Component, Tables I.C.1 and I.D.1.

[15] Centers for Medicare and Medicaid Services (CMS), "NHE Projections 2006–2016, Forecast Summary and Selected Tables," http://www.cms.hhs.gov/NationalHealthExpendData/03_NationalHealthAccountsProjected.asp#TopOfPage.

[16] See Burman, Furman, and Williams, "The President's Health Insurance Proposal—A First Look."

[17] Premium data were obtained from a 2007 update of the data used in G. Kenney, J. Hadley, and F. Blavin, "The Effects of Public Premiums on Children's Health Insurance Coverage: Evidence from 1999 to 2003," *Inquiry* 43, no. 4 (2007): 345–61.

[18] S. Zuckerman and C. Perry, "Concerns about Parents Dropping Employer Coverage to Enroll in SCHIP Overlook Issues of Affordability" (Washington, DC: The Urban Institute, 2007), http://www.urban.org/url.cfm?ID=411555.

[19] L. J. Blumberg, L. M. Nichols, and J. S. Banthin, "Worker Decisions to Purchase Health Insurance." *International Journal of Health Care Finance and Economics 1*, no. 3–4 (2004): 305–26; M. E. Chernew, K. D. Frick, and C. McLaughlin, "The Demand for Health Insurance Coverage by Low-Income Workers," *Health Services Research* 32, no. 4 (1997): 453–70; G. Kenney, J. Hadley, and F. Blavin, "The Effects of Public Premiums on Children's Health Insurance Coverage: Evidence from 1999 to 2003," J. Hadley, J. Reschovsky, P. Cunningham, G. Kenney, and L. Dubay, "Insurance Premiums and Insurance Coverage of Near-Poor Children," *Inquiry* 43, no. 4 (2007): 362–77.

[20] Congressional Budget Office, "Cost Estimate for H.R. 976."

Acknowledgment

This research was funded by the Robert Wood Johnson Foundation. The author is grateful for the advice and suggestions of Genevieve Kenney, Stephen Zuckerman, John Holahan, Len Burman, Jeff Rohaly, Edwin Park, and Stan Dorn and for the research assistance of Greg Leiserson, Allison Cook, Jennifer Pelletier, Bogdan Tereshchenko, Aaron Lucas, and Christopher Geissler.

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