Health Care Hooey

Student Handout #6: **Tax Policy Center, "The Candidates' Health Plans"**

A. *Summary of the Proposals*

Both Senator McCain and Senator Obama have advanced major proposals intended to increase health insurance coverage, reduce health care costs, and improve health outcomes. The McCain proposal would replace the existing income tax exclusion for employer-paid insurance premiums with a refundable tax credit for everyone who obtains qualifying coverage. In contrast, the Obama plan would build on the existing tax exclusion by offering a refundable tax credit to help lower-income people without employment-based insurance pay for coverage and would cover some of the cost with a tax on firms that do not offer their employees health insurance.

The McCain Proposal. The centerpiece of Senator McCain's proposals to reform health care would replace the existing income tax exclusion for employer-sponsored health insurance (ESI) premiums with a direct, refundable tax credit of $2,500 for individuals and $5,000 for families who obtain qualifying health insurance coverage. The credit would go directly to health insurers and participants could deposit any amount in excess of premiums into personal health savings accounts (HSAs). Because it loosens the historical tie between jobs and health insurance and makes health coverage portable, the proposal could reduce job lock and improve economic efficiency. We assume that self-employment health insurance deductions are eliminated. Other parts of the proposal, which TPC has not modeled, would establish subsidized high-risk pools for individuals and families that cannot obtain coverage due to preexisting health conditions, expand HSAs, introduce a number of initiatives to reduce health care costs, and develop strategies to improve long-term care.

The plan represents an improvement on President Bush's proposal to replace the income and payroll tax exclusions with a new Standard Deduction for Health Insurance (SDHI). Like the SDHI proposal, the amount of the subsidy does not depend on the cost of the insurance purchased as long as the policy meets minimum requirements. Thus, unlike the ESI exclusion, the credit does not encourage acquisition of overly comprehensive insurance and may thus help to rein in health care costs. Like SDHI, McCain's credit is available for nongroup insurance as well as ESI, although, unlike the SDHI proposal, employment-based insurance retains an advantage because compensation paid in the form of health insurance would continue to be

exempt from payroll taxes. However, unlike SDHI, which is worth most to taxpayers in high tax brackets and little or nothing to the lower-income households who are most likely to lack insurance, Senator McCain's proposed refundable tax credit would have equal value for all households with health insurance, regardless of their tax bracket.

The proposal shifts the opportunities to obtain insurance in different ways, depending on a range of factors. Workers offered insurance through their employers lose the value of the income tax exclusion but gain the credit; the combination leads to higher effective costs of insurance for some (those in the higher tax brackets or who have relatively high-cost employer-sponsored insurance) and lower costs for others (those in lower tax brackets or who have less expensive insurance). In addition, by extending a tax subsidy to nongroup coverage, everyone would gain access to lower cost insurance not tied to their jobs. Some workers, especially young and healthy ones who can find inexpensive insurance in the nongroup market, would decide that ESI was no longer their best option and would refuse their employer's offer of insurance (and expect higher wages). Some employers, finding that their average premiums increase as the healthy employees opt out, would decide to stop offering coverage. This outcome could be especially pronounced among smaller firms, which tend to face the highest premiums and the greatest risk of large premium swings if their employees' health status worsens. An aggravating factor is that employers would no longer have to offer insurance to their employees to qualify for tax-favored health insurance themselves. On the other hand, some employers—especially those who can find inexpensive health insurance—could face pressure from employees to offer coverage because the tax credit and payroll tax exemptions would make ESI affordable.

The proposal is initially very generous compared with current law. A $2,500 tax credit would be equivalent to the income tax exclusion on a $10,000 ESI premium for a taxpayer in the 25 percent tax bracket. (25 percent of $10,000 is $2,500.) A $5,000 family credit would be equivalent to a $20,000 premium. Both of these are much larger than even the most generous group health insurance premiums.

We assume, however, that, like the SDHI proposal, the McCain plan would index the tax credits based on the consumer price index, which has historically risen much more slowly than health care costs. Over time the credit would cover an ever smaller share of premiums and after-tax premiums would grow faster than health care costs. Fewer people would choose to obtain coverage and revenue losses associated with the proposal would fall.

A further complication is that the McCain plan would allow health insurers to sell across state lines. This would sound the death knell for community-rated insurance in the few states that require it, since healthy state residents could get a better deal by purchasing insurance from a different state. It would similarly threaten other state mandates to cover services such as prenatal care and childbirth. As a result, risk segmentation—in which insurers try to exclude high-cost people or charge them very high premiums—could grow quite acute, potentially causing many vulnerable policyholders to lose coverage. Senator McCain proposes to mitigate this problem by creating a subsidized high-risk pool. As we discuss below, that could either turn out to be ineffective or very expensive.

B. *Effects of Plans on Coverage, Revenues, and Distribution of Tax Burdens*

Under our assumptions, if the plans took effect in 2009, the McCain plan would cost about $1.3 trillion over ten years and the Obama plan would cost about $1.6 trillion. (Table H1.) The pattern of spending differs dramatically between the two plans. Because Senator McCain's proposed tax credit would grow in value much more slowly than health insurance premiums (and the value of the ESI exclusion), it would reduce tax revenues by $185 billion in 2009, but only $64 billion in 2018. Senator Obama's plan would cost $86 billion in 2009, but more than twice that amount in 2018—$237 billion—as more people take up subsidized insurance and the costs of the subsidies grows because subsidies are tied directly to premiums.

Both campaigns propose measures that they believe will slow the rise of health insurance premiums, which would reduce the cost of both their new subsidies and existing public programs. We have not evaluated the effectiveness of those measures. However, if the rate of growth of premiums slowed by one percentage point per year, the cost of the direct subsidies described here would fall to $1.2 and $1.4 trillion, respectively, for the two plans (shown as the Alternative Premium in Table H1). Additional savings would accrue to the Medicare, Medicaid and other public programs.

Under our assumptions, Senator Obama's plan would reduce the number of uninsured Americans by about 18 million in 2009 and 34 million in 2018. (Table H2) Almost all children would have coverage because the law would require it, but nearly 33 million adults would still lack coverage in 2018. Senator McCain's plan would have far more modest effects, reducing the number of uninsured by just over 1 million in 2009, rising to a maximum of almost 5 million in 2013, after which the number of uninsured would creep upward because the credits grow more slowly than premiums.

Both plans are highly progressive, although Senator Obama's plan targets subsidies more toward low- and middle-income households and is thus significantly more progressive than Senator

Table H1. Health Plan Costs Relative to Baseline Costs [billions of nominal dollars]

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Obama's Plan											
Baseline Premium	86	102	123	141	160	173	187	203	219	237	1,630
Alternative Premium	86	100	117	131	145	154	163	172	182	192	1,443
McCain's Plan											
Baseline Premium	185	175	164	153	141	129	116	101	83	64	1,311
Alternative Premium	185	174	161	149	136	123	108	90	71	49	1,246

Note Alternative premium estimates assume that premiums grow 1 percent slower than under the baseline case. The estimates do not account for savings in Medicare, Medicaid, or S-CHIP from lower health care costs.

McCain's proposal. (Table H3) Senator Obama's proposal would reduce the number of uninsured for low- to middle-income families more than Senator McCain's proposal. In the short run, however, McCain's proposal would result in a slightly larger reduction in the number of uninsured for high income families, but the pattern would reverse after a few years. Coverage under the McCain plan would lag over time because the tax credits would grow more slowly than health insurance premiums (which is not true of the ESI exclusion).

The relatively modest gain in coverage under Senator McCain's proposal masks a significant shift in the nature of health insurance coverage. Many small- and medium-sized employers would choose to drop coverage if their employees could obtain substantial tax credits for nongroup coverage. Also, the decline over time in value of the credit relative to premiums would reduce employers' incentives to offer insurance. By 2018, 21 million individuals would purchase insurance in the nongroup market (including the high-risk pool), but 20 million would have lost (or refused) coverage offered through their employer. Another 1 million would gain public coverage.

Many of those who would lose coverage have low incomes or high health care costs. More individuals with high health care costs could gain coverage in the nongroup market if the subsidies for the high-risk pool increased, but these subsidies could be quite expensive (and are not included in our estimates). In 2004, people in the top 5 percent of the distribution (spending more than $13,000 that year) incurred more than half of health expenditures—$267 billion. Of this amount, people without ESI spent $73 billion. Since many high-risk people in small or medium firms would likely lose coverage, the amount of spending covered by a very comprehensive high-risk pool could easily exceed $100 billion. Thus, a plan that used this method to prevent large losses in insurance coverage among the sick and needy could be extremely expensive—on the order of $1 trillion over ten years given projected health care costs.

In contrast, Senator Obama's proposal would lead to increases in the number of people insured both through employer-provided health insurance and through the nongroup insurance exchange. Although Obama's proposal is generous, the proposal would not produce universal coverage, as noted in Gruber (2008).[26] Although the proposal would benefit people in every income group on

[26] "This reflects the fact that many uninsured are uninterested in obtaining coverage even at very high subsidy rates." from page 57, "Covering the Uninsured in the U.S.", Jonathan Gruber, January 2008.

average, low- and middle-income people would stand to gain much more than high-income people. The incentives would work in different channels for different income groups, however. The number of uninsured with low incomes would fall substantially because they would take up nongroup health insurance or gain coverage under a public program. In contrast, the sizeable decrease in the number of uninsured among middle income people would come mainly from an increase in employer sponsorship. Some employers would purchase insurance through the exchange so that their lower-income employees could qualify for the subsidy, and take-up among highly subsidized employees should be high. Some employers would also be induced to offer insurance, or continue to offer insurance when they otherwise might drop coverage, because of the pay-or-play penalties and small-employer credits. Coverage would not decline over time under the Obama plan because we assume that the subsidy formula forces tax credits to grow with premiums (unlike the McCain plan where the credits would lag premium growth).

Senator Obama's plan would be more progressive than Senator McCain's (Table H2). If fully phased in, Obama's plan would increase average after-tax income by 21 percent for the bottom quintile in 2009. The subsidies would be worth 23 percent of income for the bottom quintile by 2013, rising to 27 percent by 2018. The subsidies would increase as a share of income because we assume that health insurance premiums would grow faster than income. Higher income people, however, would experience a small increase in taxes under the Obama plan because we assume that the pay-or-play tax is passed through to workers in the form of lower wages.

The benefits of the McCain plan would be distributed more broadly, raising after-tax income in 2009 about 9 percent for the bottom quintile, 3 percent for the middle quintile, and less than 1 percent for the top quintile. However, as health care inflation erodes the value of the tax credit, the subsidy would decline over time. By 2018, high-income households would be worse off than they would have been under current law because the credit would be worth less than the exclusion of ESI for those in the top tax brackets.

It should be emphasized that these estimates are simply illustrative since we had to assume so much about each candidate's plan. Moreover, estimates of changes in coverage depend heavily on assumptions about how health insurance coverage would respond to changes in after-tax premiums and subsidies.

Changes in plan design could significantly affect coverage and both candidates could fruitfully borrow features of the other's plan. For example, if Senator Obama eliminated or scaled back the existing ESI exclusion, more money would be available to subsidize health insurance premiums among those with modest incomes, expanding coverage without increasing the overall cost of the plan. If Senator McCain adapted something like Senator Obama's insurance exchange in his plan, the risk-segmentation in the nongroup market would substantially diminish, as would the need for a high-risk pool.

Table H3a
Average Federal Tax Change (including value of direct subsidies) Under Candidates' Health Proposal, Fully Phased In, 2009

Tax Unit's Cash Income	Senator McCain		Senator Obama	
	Average [$]	Percent change in after-tax income	Average [$]	Percent change in after-tax income
Lowest Quintile	-797	8.8	-1,894	21.0
Second Quintile	-1,240	4.7	-1,392	5.3
Third Quintile	-1,559	3.4	-269	0.6
Fourth Quintile	-1,641	2.2	283	-0.4
Fifth Quintile	-1,170	0.6	281	-0.2
All	**-1,241**	2.2	**-782**	1.4
80th-90th Percentile	-1,232	1.1	282	-0.3
90th-95th Percentile	-1,203	0.8	278	-0.2
95th-99th Percentile	-1,095	0.4	275	-0.1
Top 1 percent	-664	0.1	313	0.0
Top 0.1 percent	-390	0.0	401	0.0

Table H3b
Average Federal Tax Change (including value of direct subsidies) Under Candidates' Health Proposal, Fully Phased In, 2013

Tax Unit's Cash Income	Senator McCain		Senator Obama	
	Average [$]	Percent change in after-tax income	Average [$]	Percent change in after-tax income
Lowest Quintile	-713	6.8	-2,449	23.4
Second Quintile	-1,018	3.4	-1,870	6.3
Third Quintile	-1,288	2.5	-357	0.7
Fourth Quintile	-1,027	1.2	395	-0.5
Fifth Quintile	-352	0.2	389	-0.2
All	**-895**	1.4	**-1,013**	1.6
80th-90th Percentile	-494	0.4	400	-0.3
90th-95th Percentile	-470	0.3	367	-0.2
95th-99th Percentile	-140	0.1	384	-0.1
Top 1 percent	845	-0.1	411	0.0
Top 0.1 percent	960	0.0	549	0.0

Table H3c
Average Federal Tax Change (including value of direct subsidies) Under Candidates' Health Proposal, Fully Phased In, 2018

Tax Unit's Cash Income	Senator McCain		Senator Obama	
	Average [$]	Percent change in after-tax income	Average [$]	Percent change in after-tax income
Lowest Quintile	-670	5.2	-3,442	26.7
Second Quintile	-830	2.3	-2,697	7.6
Third Quintile	-830	1.4	-568	0.9
Fourth Quintile	13	0.0	562	-0.6
Fifth Quintile	921	-0.4	560	-0.2
All	**-386**	0.5	**-1,436**	1.9
80th-90th Percentile	654	-0.4	551	-0.4
90th-95th Percentile	840	-0.4	550	-0.3
95th-99th Percentile	1,277	-0.4	586	-0.2
Top 1 percent	2,655	-0.2	614	0.0
Top 0.1 percent	2,840	-0.1	803	0.0

Source:
<http://www.taxpolicycenter.org/UploadedPDF/411749_updated_candidates.pdf>