

American Medical Association

Physicians dedicated to the health of America



New Estimates Suggest that Tax Credits Can Reduce the Number of Uninsured

The AMA is pleased to see that a recent analysis undertaken by Lewin Group, Inc., on behalf of the Robert Wood Johnson Foundation, indicates that the AMA proposal to replace the current system of tax exclusion of employer contributions for health insurance with refundable tax credits that are inversely related to income has the potential to significantly reduce the number of uninsured. As an illustration of the AMA proposal, the Lewin Group estimates the impact of tax credits that start out at \$2,000 for single coverage and \$4,000 for family coverage and phases out at income of \$150,000. While their 'best' estimate is that the number of uninsured fall by 8.6 million with a cost of \$63.7 billion, the report also presents 'high-range' estimates that suggest the same tax credit structure might increase health insurance coverage by up to 16.8 million persons at a cost of \$81.5 billion.

It is important to note that the AMA proposal to reform the current system of funding the purchase of insurance is a set of principles for reform. The AMA has not endorsed any specific tax credit structure. The AMA proposal would enable individuals to choose and own their health insurance coverage, and would provide those most in need with the purchasing power to buy coverage. With decisions placed in the hands of patients and coverage becoming portable, all markets for health insurance coverage would become cost conscious and more efficient.

The Lewin Group estimates provide one illustration of the benefits of the AMA proposal. The AMA, however, believes that coupling efforts to expand Medicaid coverage to those currently eligible with nearly full coverage among lower-income individuals, who would receive tax credits large enough to cover or nearly cover the entire premium, we can achieve nearly universal coverage.

Estimation of the effects of tax credits and premium subsidies in the context of such generous and comprehensive reform is not an exact science. The AMA believes that the Lewin Group's best estimate may underestimate the impact of refundable tax credits on insurance coverage. Estimates prepared by the AMA's Center for Health Policy Research (<http://www.ama-assn.org/advocacy/cms/00anmeet.htm>) of the impact of tax credits similar to those used in the Lewin Group analysis indicate that insurance coverage could increase by up to 25 million individuals at a cost of \$40-\$65 billion.

The difference between the two sets of estimates reflects the sensitivity of the estimation to the modeling of plan offering among employers and individual purchasing, post-reform. The AMA believes that the Lewin Group's high-range estimates better reflect the coverage gains that would be realized under the AMA proposal. Elements of the analysis that support such a conclusion include:

- Conventional microsimulation models may substantially underestimate the increase in coverage that would occur from comprehensive and generous tax credit proposals, especially among low-income uninsured individuals.

It is critically important to understand that simulating the impact of a fully refundable tax credit for the purchase of insurance as a reduction in the effective (relative) price of insurance fails to appropriately model the impact of the fully refundable tax credit on insurance coverage demand or takeup rates. The contingent nature of the refundable credit and the limit on the value of the credit make any effective increases in income an all-or-nothing transfer. Lewin does not model the tax credit as an increase in income conditional on buying coverage. The insurance demand specification and the other elements in the simulation methodology which are used to capture the historical relationship between the price of private insurance and the number of persons with coverage may not

fully reflect the impact of the pure income transfer that a tax credit creates. The impact on coverage for low-income individuals is particularly large when the credit approaches 100% of premiums.

- Employer responses to the AMA proposal are uncertain. The Lewin Group estimates are at least partially driven by the assumption that firms with fewer than 50 workers not already participating in a purchasing coalition would discontinue their coverage and cash-out the health insurance benefit.

While the cash-out is modeled as an income effect, the assumption imposes an immediate and questionable increase of 26.6 million individuals in the number of uninsured. The assumption is questionable because it presumes that those firms will completely move away from sponsoring coverage (which they now do on a voluntary basis) even though there is no change in the incentives that they face. While all but 2.0 million individuals obtain coverage in the individual market, according to the Lewin Group's estimates, this assumption is largely responsible for the relatively higher costs per newly insured under AMA's proposal as compared with the other proposals analyzed. Estimates of the impact of the AMA proposal prepared by the AMA's Center for Health Policy Research use the assumption that there is no change in insurance coverage offer rates.

- The tax credit and the shift of ownership in coverage to individuals will engender a significantly different market for individually purchased coverage (both individual and group) than exists today.

Individually purchased insurance includes coverage purchased directly by individuals and coverage purchased through groups not related to employment. New opportunities to purchase coverage independent of an employer would be significantly greater if the tax benefit of coverage were delinked from employment.

Both the size and the extent of the individually purchased health insurance market will increase dramatically. With individuals empowered to pool risks independent of an employer while enjoying the same tax subsidy, the packages and premiums of the individually purchased market will mirror those in the employer market. As the individual market expands, the array of benefit plans is also expected to expand. Compared to the current non-group market, these market-driven benefit mixes and corresponding premiums will develop to more fully accommodate the level and diversity of individually selected coverage demands. As a result, premiums in all markets may fall.

The AMA also supports federal legislation to encourage the formation of small employer and other voluntary choice cooperatives by exempting insurance plans offered by such cooperatives from selected state regulations regarding mandated benefits, premium taxes, and small group rating laws, while safeguarding state and federal patient protection laws.

- Under the AMA proposal, the employer contributions for health benefits will not be included in adjusted gross income for calculating state tax liability.

Lewin estimates that the taxing employer contributions for health insurance would increase state tax revenues by \$15.6 billion. Under the AMA proposal, however, there would be no additional state tax liability. Therefore, the \$15.6 billion would in fact be spendable income, with at least a portion going to the purchase of additional insurance coverage.