

The ideal system would be a refundable tax credit for private insurance.

The Universal Health Tax Credit

How Generous Should It Be?

What Will It Buy?

It is generally accepted that the federal government should help Americans obtain health insurance, either through tax or spending subsidies. The ideal way of doing so would conform to these two principles:

- 1. The subsidies should not distort peoples' economic choices, including the choice of whether to work, the choice of where to work, the choice of how many hours to work or the choice of how much income to earn.**
- 2. The subsidy should not interfere with employer economic choices, including how many workers to hire, how many hours to employ them, etc.**

In other words, the subsidy should be as neutral as possible with respect to the operations of the economic system.

Our current system violates both of these principles. The federal government subsidizes health insurance in three main ways:

- People who get health insurance through an employer enjoy a tax exclusion; unlike wages — which are subject to income and payroll taxes — health insurance at work can be purchased with pre-tax dollars.
- People who buy insurance in the (Obamacare) exchanges may be entitled to a fixed sum

tax credit.

- People enrolled in Medicaid receive a spending subsidy — either a state government provides health insurance directly or it pays the premium for insurance to private contractor.

It is well known to health economists that families at the same income level can receive

vastly different subsidies — as much as \$10,000 or more — depending

on where they get their health insurance under this system. Aside from simple unfairness, this arrangement encourages people to make all kinds of work place

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decisions based on subsidy factors rather than economic factors.

In an ideal world, people would get the same help from government regardless of where they get their health insurance. People should be able to move among all three sectors (the group market, the individual market and Medicaid) as seamlessly as possible, without serious financial gain or loss created by the federal government.

If people have a choice between employer-provided insurance and individually purchased insurance, their choice should be made on the relative merits of the insurance, not based on federal tax law. If people have a choice between Medicaid and private insurance, they should make their choice based on the attractiveness of the alternatives, not on the basis of federal government policies.

Moving To an Ideal System: A Refundable Tax Credit for Private Insurance

The system could be greatly improved if the current subsidies were replaced with a uniform tax credit. The credit should be refundable (you get it even if you have no taxable income), advanceable (you can get it monthly, without having to wait until next April 15th) and assignable (it can be turned over to an employer or an insurance company to do the paperwork. The credit should be independent of personal income (that's why it is "universal"), but it can vary by age and geography.

We propose a tax credit of \$2,500 per adult and \$1,500 per child or \$8,000 for a family of four. To put that in perspective, the current subsidy is \$1,800 per covered life for people with employer-provided health insurance, or

\$7,200 for a family of four (again, with some variation by age and geography). So the average worker would have more take-home pay under this proposal, even if there were no change in the amount spent on health insurance.

The system could be greatly improved if the current subsidies were replaced with a uniform, refundable tax credit.

More importantly, the average worker would get the same help from the federal government for all private health insurance — whether provided by an employer or purchased in the marketplace.

What about Medicaid?

Ignoring the special circumstances of the elderly and the disabled, the amount spent by the federal government on adults and children on Medicaid should be roughly equal to the refundable tax credit for private insurance. There are two main difficulties:

1. There is considerable variation in the percent of Medicaid cost paid by the federal government across the states.
2. There is considerable variation in the efficiency with which the various states manage Medicaid.

Our proposed reforms will minimize both of these difficulties. A block grant of Medicaid funds to the states will, over time, equalize the amount of federal spending per enrollee for the entire country. Competition between Medicaid and private insurance (under which enrollees may take the state's share of Medicaid spending with them if they opt for



private coverage instead) will force Medicaid programs everywhere to turn to more efficient forms of delivery.

Impact on People in the Average Medicaid State

The latest data (per Kaiser) is 2011. The average cost for a Medicaid adult was \$4,141 and for a child it was \$2,492. However, there was a huge variance around this among the states. For adults, it ranged from \$6,928 to \$2,056 and for children it ranged from \$5,214 to \$1,656. For adults, for example, California is way below average and New York is way above average. For children, both states are close to average. We suspect these differences reflect all kinds of things other than the variation in the real cost of care.

We believe that our best Medicaid plans can

operate at 75% of the national average. (We will update this as we get more information.) Also, it looks like the federal contribution to Medicaid is about 75% of costs in the average state. Projecting forward, using actual increases in national health care spending per capita, and beyond that, projecting the future based on the most recent five years of growth, we have the following: Using the federal tax credit, every adult will be able to purchase a private plan similar to a well-managed Medicaid plan (WMMP) for a premium of \$112 a month. The premium for a child in a WMMP will be \$68 a month. For low-income families whose tax credit is supplemented by the state's average contribution to Medicaid, the monthly premiums are \$5.50 and \$3.70 respectively.

Adults:

\$5,132	Average cost of Medicaid in 2017
\$1,283	State's share of the average cost of Medicaid
\$3,849	Average cost of a well-managed Medicaid plan (WMMP)
\$2,887	Federal share of the cost of a WMMP
\$2,500	Tax credit for private insurance
\$112.41	Monthly out-of-pocket premium for someone (with the tax credit) purchasing a WMMP-like plan in the private sector in 2017
\$5.50	Monthly out-of-pocket premium for a WMMP-like plan for a low income adult who receives the federal tax credit and the state's share of the cost of Medicaid in 2017

Children:

\$3,089	Average cost of Medicaid in 2017
\$772	State's share of the average cost of Medicaid
\$2,317	Average cost of a WMMP
\$2,271	Federal share of the cost of a WMMP
\$1,500	Tax credit
\$68.04	Monthly out-of-pocket premium for someone (with the tax credit) purchasing a WMMP-like plan in the private sector in 2017
\$3.70	Monthly out-of-pocket premium for a WMMP-like plan for a low-income child who receives the federal tax credit and the state's share of the cost of Medicaid in 2017



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