DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

June 6, 1997

MEMORANDUM FOR: **ERSKINE BOWLES**
CHIEF OF STAFF (WHITE HOUSE)

FRANK RAINES
DIRECTOR (OFFICE OF MANAGEMENT AND BUDGET)

GENE SPERLING
DIRECTOR (NATIONAL ECONOMIC COUNCIL)

FROM: **SECRETARY RUBIN**
DEPUTY SECRETARY SUMMERS

SUBJECT: **Tax Incentives for Health Insurance for Children**

Because of the current mark-ups in the House Ways and Means Committee, we thought it appropriate to send you our views on tax incentives for health insurance for children. Proposals such as Congressman Stark's proposal for providing tax incentives for health insurance for children could be put forward during this process.

Tax subsidies would not be cost effective in terms of increasing health insurance coverage for children because most of the dollars would flow to those already covered by private insurance. As a result, the Administration should oppose any efforts to provide tax incentives for health insurance for children or for families. In particular, none of the $16 billion in funds allocated for health initiatives for children should be spent through the tax system.

Detailed comments on why tax subsidies for health insurance for children would not be effective are attached.

Attachment

cc: Lubick, Gruber

Tax Incentives for Health Insurance for Children

Tax subsidies would not be cost effective in terms of increasing health insurance coverage for children because most of the dollars would flow to those already covered by private insurance.

- About 90 percent of children in families with adjusted gross income (AGI) of $20,000 or more are currently insured. Thus a tax credit that is not limited to low income groups (i.e. less than $20,000 in income) would largely benefit those already covered by insurance. This is simply a giveaway to those already insured, not a marginal subsidy for new insurance.

- Generous subsidies provided to moderate and low-income families with no, or small, employer contributions are *likely to cause a significant number of employers to drop coverage for children of these workers, or to lower the share of dependent premiums that these firms pay.*

  -- Furthermore, some employees whose employers drop coverage for children, may not afford, or may not choose, to purchase health insurance. These proposals may have the unintended consequence of causing some children who are now insured to become uninsured.

- Subsidies would have to be very generous to encourage families with uninsured children to buy health insurance for their children. In recent testimony, a Congressional Budget Office director noted that a study by researchers at RAND "suggests that subsidies of as much as 60 percent would cause only one-quarter of uninsured working families to buy insurance."

- Moreover, it is difficult to purchase a "child only" health insurance policy in the private market. As a result, families are unlikely to take up insurance for the entire household based on a subsidy to the children only. Proposals designed to reduce substitution of employer-provided health insurance by creating a new children-only market are also likely to result in *adverse selection* if families are not provided a subsidy that covers almost the full premium.

- Tax incentives for health insurance for children would be difficult to administer.

  -- Health insurance premiums would come due long before cash-strapped families file their tax returns and receive a tax credit. Participation in the advance earned income credit option is low, suggesting that similar mechanisms for health insurance would not be successful.

  -- The Internal Revenue Service (IRS) would not be able to verify health insurance expenditures or most other eligibility criteria prior to payment of the credit, but would not find it cost-effective to recapture erroneous payments to taxpayers. For example, some have proposed that a waiting period be added in order to

discourage employer dropping. The IRS would not have the capacity to track employer-provided health insurance coverage for children.

- The Omnibus Budget Reconciliation Act of 1990 expanded the Earned Income Tax Credit (EITC) by up to $465 (1993 dollars) for taxpayers who purchased health insurance for qualifying children. In 1993, Congress enacted a Clinton Administration proposal to significantly expand the basic EITC which was financed, in part, by the repeal of the supplemental health insurance credit.

  -- The repeal of the health insurance credit was justified, in part, on administrative grounds. The IRS could not easily verify eligibility for the health insurance supplement because it did not have independent information on health insurance coverage or costs. Confused taxpayers made unintentional errors when claiming the supplement because they did not understand the rules regarding qualifying health insurance.

- Expansion of Medicaid or providing grants, as currently proposed by the Administration, would be more effective at reducing the number of uninsured children than providing tax incentives.

  -- It would be easier to target subsidies to near poor families, the group most likely to have uninsured children, through expansions of Medicaid or through a grant program than through the tax system. Tax proposals are more likely to provide more generous subsidies to higher income families than expenditure programs, causing more employer dropping.

  -- An expenditure program would be able to deliver the subsidy up front when families need it to pay their premium.

  -- State programs would allow for variation in program design and state specific conditions so that efforts to avoid substitution for employer-provided health insurance could be tested before a one-size-fits-all program were adopted.