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Financing Considerations for Potential State Healthcare Policy Changes

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Presented to:
Assembly Select Committee on
Health Care Delivery Systems and Universal Coverage
Hon. Joaquin Arambula, Co-Chair
Hon. Jim Wood, Co-Chair

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Current Healthcare Coverage and Spending Landscape

☑ ***93 Percent of Californians Currently Insured.*** The percent of Californians with health insurance has increased dramatically since 2013, from around 83 percent of the state's population to around 93 percent of the state's population in 2017.

☑ ***Health Insurance Enrollment by Type of Coverage in California.*** As shown in Figure 1, Californians receive health insurance coverage from a variety of sources, including:

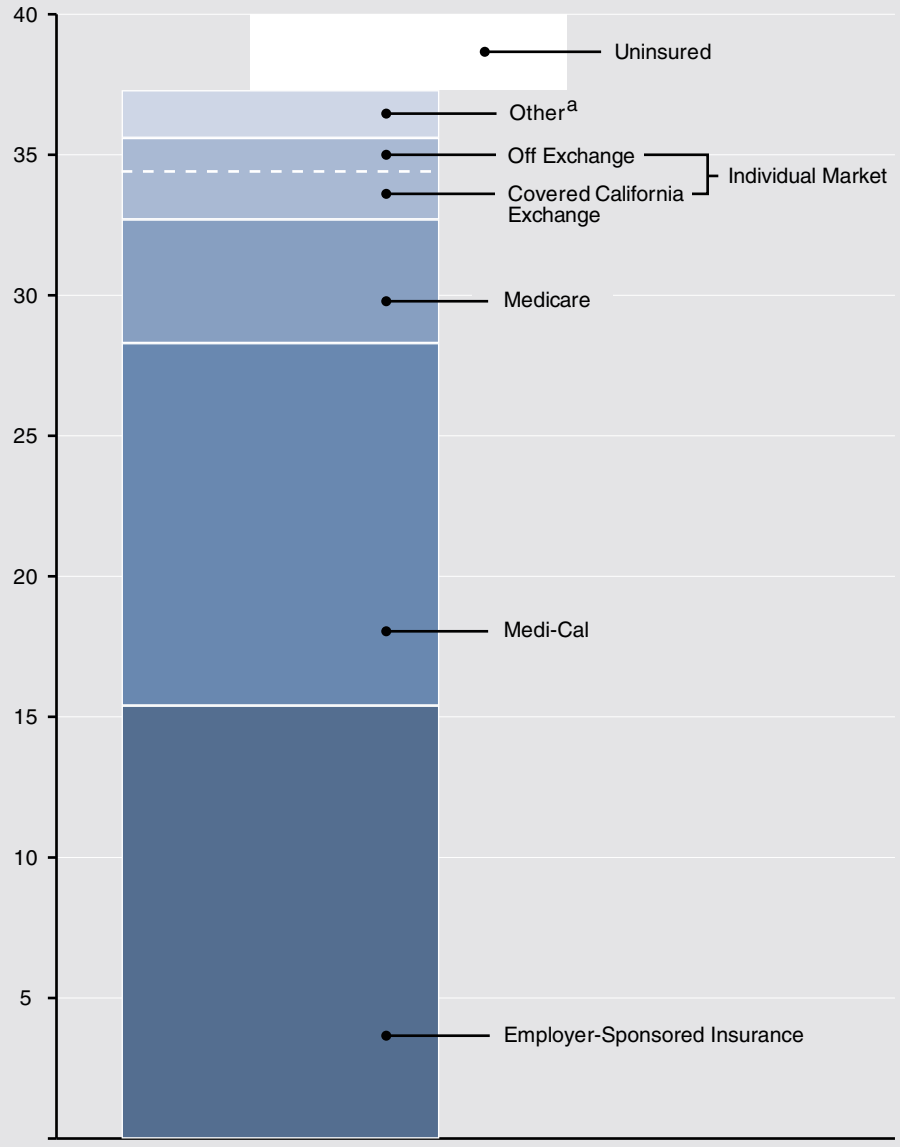
- ***Employer-Sponsored Insurance (ESI).*** The most common type of healthcare coverage in the state, ESI is health insurance that is provided through employers. Often, the employer and the employee share the cost of the monthly insurance premiums.
- ***Medi-Cal.*** Medi-Cal, the state's Medicaid program, provides generally no-cost healthcare coverage to the state's low-income residents. Eligibility rules differ for different low-income populations, but generally limit eligibility to adults with incomes below 138 percent of the federal poverty level (FPL) and children in families with incomes below 266 percent of the FPL.
- ***Medicare.*** Medicare is the federal health insurance program for qualifying persons over age 65 and certain people with disabilities.
- ***Individual Market.*** The individual market constitutes commercial health insurance purchased by individuals who do not receive health insurance through their employers. The majority of people with individual market health insurance coverage purchase insurance through the California Health Benefit Exchange (Covered California).
- ***Other Coverage Types.*** A relatively small number of Californians obtain health coverage from alternative sources to those identified above, such as the public healthcare coverage provided to current military members, military veterans, and inmates of the state's prisons.

Current Healthcare Coverage and Spending Landscape *(Continued)*

Figure 1

California Health Insurance Enrollment by Type of Coverage

Estimated 2017-18 (In Millions)



[a] Category includes current military members, military veterans, and inmates who receive coverage through their respective public programs.

Current Healthcare Coverage and Spending Landscape *(Continued)*

☑ ***About Three Million Uninsured Californians.*** The remaining uninsured are believed to fall into the following two main groups:

- ***Undocumented Immigrants.*** Among the somewhat less than two million estimated uninsured undocumented immigrants, a majority are believed to have incomes low enough that they would qualify for Medi-Cal but for their immigration status. (The state recently extended full Medi-Cal coverage to undocumented immigrant children, leaving only adults in this income range without full Medi-Cal eligibility.) Most of the remaining uninsured undocumented immigrants are estimated to have incomes that would allow them to qualify for federal insurance subsidies through the Covered California but for their immigration status. The remaining uninsured undocumented immigrants are those with incomes too high for them to qualify for either Medi-Cal or federal health insurance subsidies regardless of their immigration status.

- ***Other Remaining Uninsured.*** Of the somewhat more than one million uninsured state residents with citizenship or documented immigration status, around two-thirds are estimated to be eligible for Medi-Cal or subsidies through Covered California but have not enrolled. The remaining one-third represents state residents with incomes too high to qualify for publicly supported healthcare coverage programs.

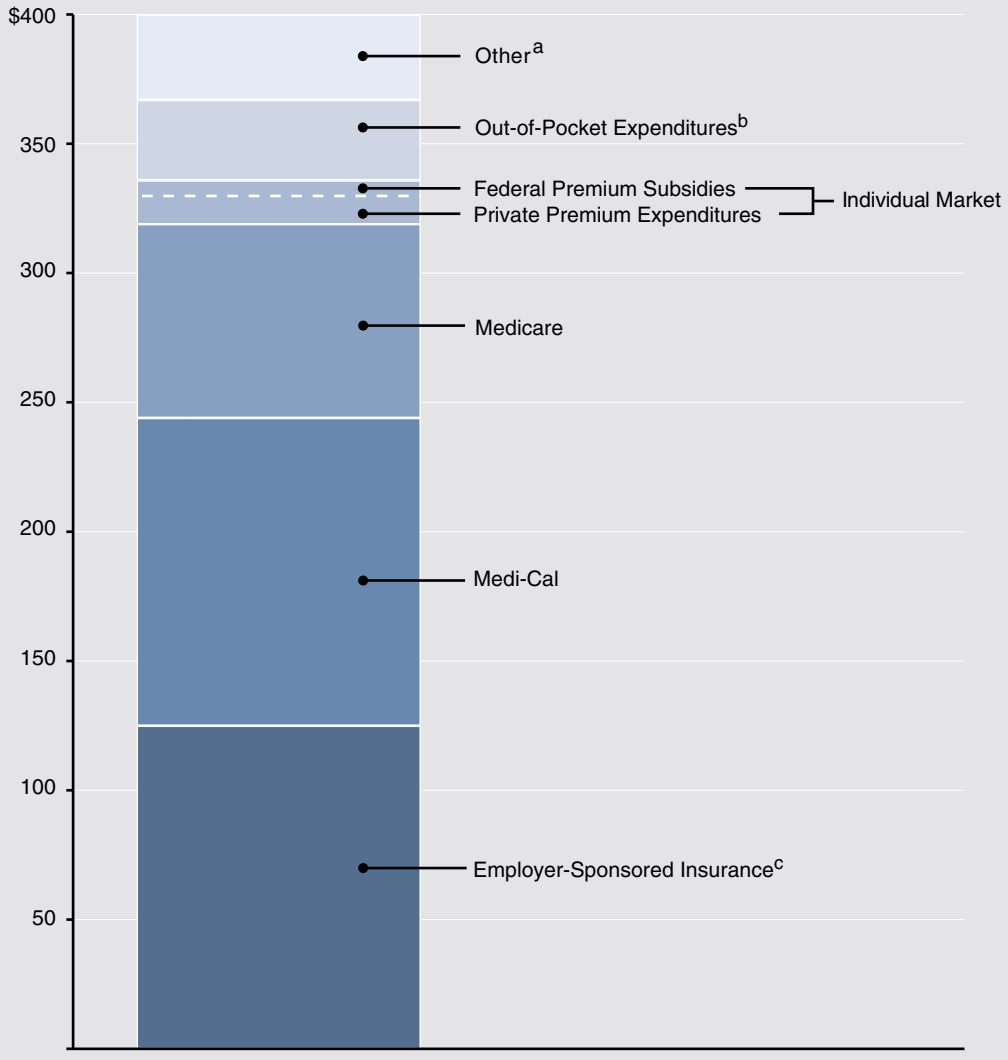
☑ ***$400 Billion in Estimated Healthcare Expenditures in California in 2017-18.*** As summarized in Figure 2, we estimate around $400 billion will be spent on healthcare in California in 2017-18 from all public and private sources. Per capita health care expenditures are estimated to be approximately $10,000 in 2017-18. Per capita expenditures vary significantly by funding source, with spending on Medicare enrollees being nearly double that of enrollees in other types of healthcare coverage.

Current Healthcare Coverage and Spending Landscape *(Continued)*

Figure 2

California Healthcare Expenditures by Payer or Payment Type

Estimated 2017-18 (In Billions)



[a] Includes, for example, federal health care expenditures for military members and veterans, state expenditures for the uninsured, and workers' compensation health care spending.

[b] Includes consumer expenditures on copays, deductibles, and other health care costs not covered by insurance, and does not include premiums.

[c] Includes expenditures on health insurance premiums made by both employers and employees.

Current Healthcare Coverage and Spending Landscape *(Continued)*

☑ ***Over One-Half of Healthcare Spending in the State Comes From Public Sources.*** Public spending represents spending by federal, state, or local governments. Total public healthcare spending in 2017-18 is estimated to be roughly $200 billion. The following government-financed programs account for most public healthcare spending:

- ***Medi-Cal.*** Over $100 billion in estimated spending.
- ***Medicare.*** Around $75 billion in estimated spending.
- ***Federal Subsidies Through Covered California.*** Around $6 billion in estimated spending.

☑ ***Tax Exclusion of Employer-Sponsored Health Insurance Benefits.*** Federal and state tax law provide an indirect tax benefit for employer-sponsored insurance by not treating the benefits employers provide their employees in the form of health insurance benefits as taxable income to the employee. This indirect federal and state tax benefit is estimated to be worth (in terms of foregone revenues) between $40 billion and $50 billion in California. About 75 percent of this indirect tax benefit comes from the federal government.

☑ ***Federal Spending Accounts for Around Three-Fourths of Public Healthcare Expenditures.*** The federal government is estimated to provide over $150 billion in funding for California's healthcare system in 2017-18—not including the federal tax exclusion of employer-sponsored insurance—with the vast majority funding Medicare and Medi-Cal. State and local funding sources, such as what the state spends on the Medi-Cal program, account for the remaining quarter of public funding for healthcare in the state.

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Current Healthcare Coverage and Spending Landscape *(Continued)*

☑ ***Major Private Sources of Healthcare Spending.*** The following sources account for the majority of private spending on healthcare in the state (totaling an estimated roughly $200 billion in 2017-18):

- ***Employer-Sponsored Insurance Premiums.*** Between $100 billion and $150 billion in estimated spending.
- ***Individual Market Premiums.*** Over $10 billion in estimated private spending—net of any federal subsidies provided to residents through Covered California.
- ***Out-of-Pocket Spending.*** Between $25 billion and $35 billion in estimated private spending. Out-of-pocket expenditures include consumer expenditures on copays, deductibles, and other healthcare costs not paid by insurers. They do not include spending on premiums.

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Publicly Financed Healthcare Program

☑ ***Analyzed the Cost of a Publicly Financed Healthcare Program That Would Potentially Cover All California Residents.*** In 2017, the Legislative Analyst's Office analyzed the cost of a publicly financed healthcare program that would replace the existing multipayer healthcare system. This program would generally provide exclusive financing of healthcare services in the state and would result in a very substantial change to healthcare coverage in the state. Our analysis below is based on the same set of assumptions used in that earlier analysis.

☑ ***Estimates Highly Dependent on the Design of the Publicly Financed Healthcare Program and Other Major Assumptions.*** A publicly financed healthcare program that is structured differently than what we analyzed could differ in projected cost by tens of billions of dollars. Moreover, changes to any of the assumptions we made—for example around healthcare utilization rates or the payment levels paid to healthcare providers—could change the total projected cost estimate by tens of billions of dollars. Our major assumptions included:

- ***Cover Nearly All Californians by Incorporating Existing Federal and State Funding Streams.*** Our estimate assumed nearly all Californians could be covered by the publicly financed healthcare program. However, major fiscal, legal, and practical barriers may prevent a publicly financed healthcare program from covering all or potentially even most California residents. For example, waivers of federal law would be needed to incorporate federal funding for Medi-Cal, Medicare, and individual market premium subsidies into a publicly financed healthcare program.
- ***Fee-For-Service (FFS) System That Pays Providers at Medicare Rates.*** Our estimate assumed a FFS healthcare delivery system that would pay providers approximately at Medicare rates.

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Publicly Financed Healthcare Program *(Continued)*

- ***Comprehensive Package of Covered Benefits.*** Our estimate assumed a comprehensive package of covered benefits under the publicly financed healthcare program. Many of these benefits are not currently covered under most health insurance products, such as long-term care, dental, and vision benefits.
- ***No Cost Sharing.*** Our estimate assumed no copays or deductibles for beneficiaries of the publicly financed healthcare program. No cost sharing results in greater upfront tax revenues needed to fund the program and potentially results in increased healthcare utilization under the program.

☑ ***$400 Billion in Total Costs.*** We estimated $400 billion in total costs to run a publicly financed healthcare program operating with the major assumptions outlined above. This estimate is subject to significant uncertainty. The vast majority of the estimated $400 billion would pay directly for healthcare services. We assume that administrative costs would be less than 10 percent of total program cost.

☑ ***$200 Billion in Potentially Available Public Funding.*** Our estimate assumed the approximately $200 billion in existing public funding for healthcare in California could be redirected to pay for the publicly financed healthcare program. Of this amount, $150 billion represents federal funding that the federal government would have to approve to be used in a publicly financed healthcare program.

☑ ***$200 Billion in Additional State Revenue Needed.*** We estimated $200 billion in new state revenue would be needed to fund the difference between our estimate of the total cost of a publicly financed healthcare program and our upper-bound estimate of existing public funding that could potentially be redirected to pay for a publicly financed healthcare program.

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Covering the Uninsured Through the Existing Health Care System

☑ ***Different Policy Approaches Target Different Uninsured Subpopulations.*** We have been asked to provide a brief overview of several potential approaches to further reduce the number of uninsured Californians through the existing system as an alternative to a publicly financed healthcare program with universal coverage. Different approaches will be more effective for certain subpopulations of the remaining uninsured. Below, we summarize several proposals to further reduce the number of uninsured state residents. While we are not at this time able to provide cost estimates for these proposals, we note that their cost would be in the range of several billions of dollars to $10 billion. We would also note that it is possible to implement the following proposals gradually, such as by extending coverage incrementally based on predetermined age groupings, thereby lowering the initial implementation costs.

Targeting Uninsured Low-Income Undocumented Immigrants

Low-income undocumented immigrants likely account for at least one-half of the approximately three million remaining uninsured state residents. (We define low-income as having income below 400 percent of the FPL, which represents the cutoff point for eligibility for federal health insurance subsidies through Covered California.) The policies described below have potential to make affordable healthcare coverage available to most low-income, uninsured undocumented immigrants.

☑ ***Option: Full-Scope Medi-Cal Coverage for Income-Eligible Undocumented Immigrant Adults.*** Undocumented immigrants over age 18 are currently ineligible for full-scope Medi-Cal coverage. We estimate that there are somewhat more than one million undocumented immigrant adults who would qualify for full-scope Medi-Cal but for their immigration status. The majority of these individuals are already enrolled in Medi-Cal for what is known as "restricted-scope" coverage, which covers these enrolled individuals' emergency and pregnancy-related costs.

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Covering the Uninsured Through the Existing Health Care System *(Continued)*

☑ ***Option: Individual Health Insurance Market Subsidies for Income-Eligible Undocumented Immigrants.*** Undocumented immigrants are currently ineligible for federal health insurance subsidies (tax credits) through Covered California. We estimate that there are between 300,000 and 500,000 undocumented immigrants who would be eligible for federal insurance subsidies but for their immigration status. The state could potentially establish a state-funded system of health insurance subsidies for undocumented immigrants who purchase coverage on the individual market that is modeled after the federal system.

Targeting the Other Remaining Uninsured

☑ ***Option: State "Wraparound" Health Insurance Subsidies for Individual Market Insurance.*** Somewhat more than one million uninsured Californians have incomes too high to qualify for Medi-Cal, but who may find the cost of commercial health insurance to be unaffordable at their income level (even accounting for federal subsidies). One approach to extending coverage to this group is to provide state wraparound health insurance subsidies to reduce the cost of commercial health insurance for Californians who purchase coverage on the individual market. Such wraparound subsidies, for example, could increase health insurance coverage for the following populations:

- ***Uninsured Individuals With Incomes Too High to Qualify for Federal Health Insurance Subsidies.*** Federal health insurance subsidies are not available to individuals with incomes greater than 400 percent of the FPL. We estimate that there are less than one million uninsured state residents with incomes above this level. To help these individuals obtain health insurance coverage, the state could offer state-funded wraparound health insurance subsidies to individuals ineligible for federal health insurance subsidies. These state subsidies could, for example, be designed similarly to federal subsidies and limit personal health insurance premium expenditures to a certain percentage of household income.

Covering the Uninsured Through the Existing Health Care System *(Continued)*

- ***Uninsured Individuals Who Are Eligible for Federal Health Insurance Subsidies.*** A portion of the remaining uninsured are individuals who are eligible for federal health insurance subsidies but have elected not to purchase coverage, potentially because they deem the coverage unaffordable. A state wraparound subsidy program could be designed to further lower the cost of individual market health insurance plans and encourage additional participation in the individual market, lowering the number of uninsured Californians.

State Individual Mandate

A state individual health insurance mandate would require state residents to maintain health insurance coverage or otherwise pay a penalty.

☑ ***State-Level Individual Mandate Could Replace the Repealed Federal Mandate.*** The Patient Protection and Affordable Care Act established a nationwide individual mandate. The recently enacted federal tax bill repealed the federal individual mandate penalty effective in 2019. California could consider a state individual mandate—enforced through the state tax system—to replace the in effect expiring federal individual mandate. The benefit of a state individual mandate would be to provide an incentive, in particular to the relatively young and healthy, to maintain healthcare coverage.

☑ ***Almost 800,000 Californians Paid the Federal Individual Mandate Penalty in 2015.*** Nearly 780,000 Californian tax filers—4.4 percent of total Californian tax filers—paid almost $380 million in federal individual mandate penalties in 2015.

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Healthcare Financing Considerations and Options

Personal Income Tax

☑ ***Largest Tax in California.*** The personal income tax (PIT) is a tax on household income, such as wages and salaries, business income from partnerships and proprietorships, and capital gains on sales of assets such as stocks. Rates currently range from 1 percent to 12.3 percent, increasing as the taxpayer's income increases. (In addition, Proposition 63 [2004] imposes a 1 percent rate on income over $1 million.) The PIT raised $85 billion in 2016-17.

☑ ***Options for Raising PIT Revenue.*** Increase marginal rates and/or reduce deductions, exemptions, and credits. Proposal could be tailored to affect taxpayers similarly across the income spectrum or concentrate the tax increase on a certain group of taxpayers.

☑ ***Tax Rates That Would Provide $10 Billion and $200 Billion.*** Figure 3 below summarizes tax rates necessary to raise $10 billion and $200 billion. (In producing our estimates, we assumed no change in the tax base and raised rates equally across the board.) We estimate that a 10 percent increase in rates would raise $10 billion in additional revenue. (For example, the 12.3 percent rate would need to increase to 13.5 percent—a 10 percent increase.) In order to raise $200 billion, we estimate that PIT rates would have to be nearly three times higher.

Healthcare Financing Considerations and Options *(Continued)*

Figure 3

Personal Income Tax Rates Necessary to Raise Additional Revenues

Single Filer Bracket	Joint Filer Bracket	Current Rate	Rate Needed to Raise an Additional $10 Billion	Rate Needed to Raise an Additional $200 Billion
$0—$8,608	$0—$17,216	1.0%	1.1%	2.9%
$8,608—$20,407	$17,216—$40,814	2.0	2.2	5.8
$20,407—$32,208	$40,814—$64,416	4.0	4.4	11.6
$32,208—$44,711	$64,416—$89,422	6.0	6.6	17.4
$44,711—$56,505	$89,422—$113,010	8.0	8.8	23.2
$56,505—$288,635	$113,010—$577,270	9.3	10.2	26.9
$288,635—$346,363	$577,270—$692,726	10.3	11.3	29.8
$346,363—$577,271	$692,726—$1,154,543	11.3	12.4	32.7
Over $577,271[a]	Over $1,154,543[a]	12.3	13.5	35.6

[a] Figure does not reflect 1 percent surcharge on income over $1 million used for mental health programs.
Note: Brackets shown are estimates for 2019 tax year.

Property Tax

☑ ***Key Local Government Revenue Source.*** Property taxes are the main tax levied by local governments in California. In 2016-17, the property tax raised around $60 billion. Revenues remain in the county in which they are collected and are allocated amongst cities, counties, schools, and special districts.

☑ ***How Property Tax Works.*** The property tax is determined by multiplying the taxable value of property (assessed value) by the property tax rate—1 percent plus voter-approved add-ons. Assessed value generally equals the property's purchase price, adjusted annually by 2 percent or the rate of inflation, whichever is lower.

☑ ***Options.*** Increase tax rate or change assessment system. Assessment system could instead be based on market value or could allow assessed values to grow by a maximum rate greater than the current 2 percent cap. Some have proposed a "split roll" whereby commercial properties are taxed at their market value but property taxation of residential properties is unchanged.

Healthcare Financing Considerations and Options *(Continued)*

☑ ***Increasing Property Tax Relatively Difficult.*** Proposition 13 (1978) amended the State Constitution to limit property taxes. As such, proposals to increase property taxes would require a two-thirds vote of the Legislature and majority vote approval of the statewide electorate.

☑ ***Tax Rates That Would Provide $10 Billion and $200 Billion.*** Assuming no change in the property tax base or assessment system, we estimate that a 0.2 percentage point increase in the property tax rate would raise an additional $10 billion annually. Raising $200 billion from the property tax would require an increase of 3.7 percent, bringing the average property tax rate in the state to nearly 5 percent.

Sales and Use Tax

☑ ***State and Local Revenue Source.*** The sales and use tax (SUT) is the third largest tax in California. The SUT currently raises about $55 billion annually. The statewide average rate currently is 8.5 percent, but local governments have some flexibility over what rate to levy in their jurisdiction. The SUT ranges from 7.25 percent in several rural counties to 10.25 percent in parts of Los Angeles County. Roughly two-thirds of the SUT is either deposited into the state General Fund or used for state-funded local programs. The other one-third of the SUT goes to local governments for public safety, transportation, and other programs.

☑ ***Options.*** Raise tax rate or broaden tax base. Changes in the tax base could range considerably. For example, a minor change would be amending the State Constitution to apply the SUT to candy, snack foods, and bottled water. Alternatively, a major change would be applying the SUT to services, such as health care and education services.

Healthcare Financing Considerations and Options *(Continued)*

- ***Tax Rates That Would Provide $10 Billion and $200 Billion.*** Assuming no change in the SUT tax base, we estimate that a $10 billion increase in revenue would require a 1.4 percentage point increase in the SUT rate. Raising $200 billion from the SUT would require an increase of roughly 28 percentage points, bringing the average SUT rate in the state to about 37 percent.

Payroll Tax

- ***State Currently Has a Few Small Payroll Taxes.*** A payroll tax is imposed on employees' wages and salaries and is collected from employers. The state levies payroll taxes for unemployment insurance, employment training, and state disability insurance.

- ***Options.*** In levying a new payroll tax, the state would face choices about the tax base and rates. For example, federal payroll tax for social security is imposed on wages and salaries up to $128,400, but the state could choose a different tax base. Similarly, while the federal payroll tax imposes a flat rate across the income range, the state conceivably could impose rates that increase with increases in income, similar to the PIT. The state could impose a payroll tax on employees and/or employers.

- ***Tax Rates That Would Provide $10 Billion and $200 Billion.*** We estimated what payroll tax rates would be necessary assuming a flat tax rate and that the tax would apply to all wages and salaries. We estimate that a rate of 0.8% would raise $10 billion, while a rate of 14 percent to 15 percent would be needed to raise $200 billion.

Gross Receipts Tax

- ***Tax on Business Sales.*** A gross receipts tax (GRT) is a tax on all business sales—including goods and services. Whereas the SUT is collected at the retail level, a GRT is collected on sales at all stages of production. The state currently does not have a GRT.

Healthcare Financing Considerations and Options *(Continued)*

- ***Potentially Large Negative Economic Effects.*** Assuming a GRT is a key part of a major change in California's healthcare landscape, it likely would negatively affect the economy. Specifically, a substantial GRT would create strong incentives for businesses to become more "vertically integrated"—combining many stages of production into a single business, rather than many businesses. In a hypothetical example, a GRT could create an incentive for a single business in the clothing industry to grow, refine, and process cotton; produce yarn; manufacture clothing; and sell the clothing to customers, instead of specializing in one or two of those activities. Such changes could reduce the size of the tax base and be a drag on economic output more broadly.

- ***Tax Rates That Would Provide $10 Billion and $200 Billion.*** We estimate that a GRT rate of 0.25 percent would be necessary to raise $10 billion. Levying a GRT would be administratively costly—likely roughly $1 billion—making it an impractical tax to levy for such a small revenue increase. In order to raise $200 billion, we estimate the state would have to impose a GRT rate of roughly 5 percent. Because the state does not currently levy a GRT, we have limited data upon which to base an estimate, making these estimates subject to great uncertainty.

Key Public Financing Considerations

- ***Larger Financing Packages Will Be Subject to Greater Uncertainty in Estimating Revenues Raised.*** On the low end of revenue raising proposals, an estimate of the revenue raised from a tax policy change will be subject to some degree of Uncertainty. As financing options get larger, taxpayer behavioral response will become more uncertain, thus increasing estimating Uncertainty. In the $200 billion range, revenue collections could easily fall short of initial estimates by tens of billions of dollars.

Healthcare Financing Considerations and Options *(Continued)*

☑ ***Minimize Economic Distortions.*** Economists tend to prefer taxes with broad bases and low rates because they minimize economic distortions—that is, when individuals and firms make less efficient decisions than they would have made without the tax. For example, California's SUT has a broad base and an average statewide rate of about 8.5 percent. If the SUT were levied on vehicles only, however, the rate would have to be many times higher in order to raise the same amount of revenue. If the SUT rate on vehicles were 50 percent, consumers likely would change their behavior in response to the tax rate—for example, they may to keep their vehicles longer or purchase less expensive vehicles. Taxes with narrow bases and high rates generally result in a drag on overall economic output.

☑ ***Consider Taxpayer Behavioral Response.*** The larger the tax increase, the more significant the behavioral changes. For example, doubling or tripling PIT rates would result in some taxpayers leaving California. If the Legislature considers more significant changes to the healthcare system, increasing revenues from multiple taxes could help minimize these behavioral responses.

☑ ***Minimize Revenue Volatility.*** A key challenge in California budgeting over the past two decades has been revenue volatility. Revenue volatility would differ considerably across different taxes and specific proposals. For example, a $10 billion PIT increase concentrated on high-income taxpayers would be a highly volatile revenue source. By contrast, a $10 billion increase in the SUT would be less volatile. A more predictable revenue source would minimize disruptions in providing services.

☑ ***Establish Prudent Reserve.*** A budget reserve may be necessary under any of the health program augmentations discussed earlier. For example, Proposition 2 (2014) created a rainy day reserve for the state budget. Under the Governor's proposed budget, the state would build a reserve equal to

Healthcare Financing Considerations and Options *(Continued)*

10 percent of General Fund tax revenue. Building a reserve both keeps the spending base at a more sustainable level and helps the Legislature minimize spending cuts, tax increases, and other actions in the next economic downturn. In the context of health program options, a reserve would help avoid program disruptions when revenues decline. In general, the need for a reserve increases with a more volatile revenue source.

☑ ***Consider Revenue Growth.*** Over the long term, different revenue sources grow at different rates. Varying growth is explained by several factors, such as growth rates in underlying tax bases. Figure 4 below compares growth in the three biggest taxes levied by the state and local governments.

☑ ***Consider Taxpayer Incidence.*** Another factor to consider is the incidence of various financing options—that is, how the tax burden is distributed by income level and how the tax burden is shared by consumers, workers, and businesses.

☑ ***Minimize Administration Costs.*** Administrative costs of proposals will vary widely. An increase in PIT or SUT rates, for example, would have relatively low administration costs because the state already has established administration programs for those taxes. On the other hand, the administration costs associated with establishing a new GRT could total roughly in the high hundreds of millions of dollars.

Healthcare Financing Considerations and Options *(Continued)*

Figure 4

Sales Tax Growth Slower Than Property and Income Taxes

Total Percent Change, 2015-16 Dollars