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Funding and Implementing Individual Health Insurance Market Affordability Policies

PRESENTED TO:

Assembly Health Committee
Hon. Jim Wood, Chair

Assembly Budget Subcommittee No. 1 on Health and Human Services
Hon. Joaquin Arambula, Chair

Senate Committee on Health
Hon. Richard Pan, Chair

Senate Budget and Fiscal Review Subcommittee No. 3 on Health and Human Services
Hon. Richard Pan, Chair

LEGISLATIVE ANALYST'S OFFICE

Overview of Governor's Affordability Proposals

The Governor proposes two policies to make health insurance purchased on the individual market (including Covered California) more affordable.

- ***Create Individual Mandate With Penalty.*** First, the Governor proposes to create a state individual mandate, under which most Californians would be required to have specified minimum coverage or be subject to a financial penalty. The proposed state individual mandate would be modeled on the federal individual mandate before Congress set the federal penalty to zero (effective 2019). The Franchise Tax Board (FTB) would administer the state individual mandate.

- ***Provide State Insurance Subsidies.*** Second, the Governor proposes to use penalty revenues from the proposed state individual mandate—estimated at roughly $500 million annually—to fund insurance subsidies for people purchasing coverage in the individual market. So far there are few details on the structure of the proposed subsidies. However, the administration has indicated that the proposal would make assistance available to households with incomes between 250 percent and 400 percent of the federal poverty level (FPL)—households that are currently eligible for federal subsidies—and households with incomes between 400 percent and 600 percent of FPL that are currently ineligible for federal subsidies.

LAO Comments on Governor's Proposals

Individual Mandate With Penalty Likely a Cost-Effective Option. . . A state individual mandate policy would (1) generate state revenues from individuals paying the penalty and (2) likely result in state costs in Medi-Cal—potentially in the hundreds of millions of dollars—that would at least partially offset penalty revenues. On net, a state individual mandate is likely a very cost-effective option for increasing coverage and reducing premiums in the individual market, particularly for households that currently do not receive federal subsidies.

. . . But Does Involve Trade-Offs. A state individual mandate would have additional costs beyond the state budget. Some individuals would have the cost of purchasing coverage they otherwise would not have purchased, but would benefit from having insurance. Revenues from the individual mandate would come at the expense of individuals who choose to pay the penalty instead of obtaining coverage. These individuals would not benefit from insurance coverage.

Proposed Subsidies Would Be Relatively Modest, but Would Ease Compliance With State Mandate. Assuming total state spending on proposed insurance subsidies of roughly $500 million (consistent with the rough estimated amount of penalty revenues from the individual mandate), these subsidies would be relatively modest compared to the existing federal insurance subsidies (estimated to be over $6 billion in California in 2018). At the same time, these subsidies would reduce the cost of coverage for households that are eligible to receive them and would ease compliance with a state individual mandate.

LAO Comments on Governor's Proposals

(Continued)

Recommendations

- ***Individual Mandate Proposal Warrants Serious Consideration.*** On balance, we recommend that the Legislature give serious consideration to the Governor's proposal.

- ***Consider Proposed State Subsidies Among Range of Additional Policy Options to Improve Affordability.*** We think it makes sense to consider a state individual mandate in conjunction with policies to further reduce households' insurance costs. We recommend that the Legislature consider the Governor's proposal in the context of a range of policy options, such as those presented in a recent report by Covered California, and consider what policies would best align with the Legislature's policy priorities and desired level of General Fund commitment.

Options for Funding Affordability Policies

Revenues From State Individual Mandate Penalty

- ***Dedicating Penalty Revenues to Fund Affordability Policies Creates Conflicting Goals.*** The policy goal of the individual mandate penalty as a deterrent against people foregoing health insurance coverage is at odds with the fiscal goal of generating funds for affordability policies. Prioritizing the policy goal would mean maximizing compliance with the mandate, which would have the effect of reducing funding available for those policies. Prioritizing the fiscal goal would mean maximizing penalties, or minimizing compliance with the mandate.

- ***One-Time State Funding Might Be Required Until Penalty Funds Are Available.*** Revenues from a state penalty modeled after the federal penalty would first be collected through state tax returns in the months following its first year of implementation. If the Legislature wished to use penalty funds to cover some or all of the costs of subsidies but wants to avoid the penalty being in place before subsidies are available, the state would likely need to provide one-time startup funding from other sources to cover the costs of the first year of subsidies.

Options for Funding Affordability Policies

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Renew Managed Care Organization (MCO) Tax Package

- ***MCO Tax Package Generates General Fund Savings in Medi-Cal.*** MCOs are health insurers that are regulated by the Department of Managed Health Care or the Department of Health Care Services. The state currently levies a tax on MCOs, which leverages significant federal funding in the Medi-Cal program. As part of the MCO tax package, the state also provides tax reductions for some insurers. Overall, the MCO tax package results in significant net General Fund savings, estimated at as much as $1.5 billion in 2018-19.

- ***Current MCO Tax Package Expires in June 2019.*** The MCO tax package is governed by the terms of state law and federal approvals and is scheduled to sunset at the end of 2018-19. The Governor has not proposed to extend the MCO tax package as part of his 2019-20 budget proposal. Recent federal approval of similarly structured health insurer taxes in a few other states suggest that the federal government would likely approve a proposed renewal of California's MCO tax.

- ***Renewing MCO Tax Would Generate Savings That Could Support Various Priorities.*** Renewing the MCO tax package would generate an estimated General Fund savings of between $700 million and $800 million in 2019-20 and potentially around $1.5 billion in later years when the full fiscal benefit of the tax package is realized. General Fund resources freed up from a renewed MCO tax package could be used to fund various priorities, including individual market affordability policies.

Options for Funding Affordability Policies

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Tax on Sugary Drinks

- ***Sugary Drink Taxes Have Both Fiscal and Policy Goals.*** First, an excise tax on sugary drinks is one of many options available to policymakers who want to raise revenues. Like other excise taxes, the burden of paying the tax would disproportionately fall on some groups relative to others. Second, an excise tax on sugary drinks would reduce sugary drink consumption and potentially lead to improvements in health. The consumer response to a sugary drink tax would be complex, so the net health effects are uncertain.

- ***Implementing Sugary Drink Tax Would Involve Many Design Decisions.*** Key design choices include what types of drinks should be included in the tax base; whether the tax should be based on the volume of a drink, a drink's sugar content, or something else; and what the tax rate should be.

- ***Dedicating Sugary Drink Tax Revenues to Fund Affordability Policies Could Be Problematic.*** A sugary drink tax's fiscal goal of raising revenue and its policy goal to reduce consumption of sugary drinks can conflict. A sugary beverage tax might decline over time (similar to some other excise taxes, such as the tobacco tax), consistent with the tax's policy goal, but in conflict with the fiscal goal of providing predictable ongoing funding for a state priority such as individual market affordability policies.

Options for Funding Affordability Policies

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State General Fund

- ***Existing General Fund Resources.*** The Legislature could allocate existing General Fund resources to fund affordability policies. This would require diverting funds from other ongoing spending priorities.

- ***Increases to General Fund Revenue Sources.*** Three taxes—the personal income tax, the sales and use tax, and the corporation tax—provided 97 percent of General Fund revenues in 2017-18. The General Fund also receives revenues from the insurance tax and taxes on tobacco and alcoholic beverages. The Legislature could consider making changes to increase revenues from one of these sources to fund affordability policies.

- ***Depositing New Revenues in General Fund to Fund Insurance Subsidies Would Have Benefits.*** As described above, dedicating revenues from an individual mandate penalty or sugary drink tax to fund subsidies, such as by depositing them in a special fund, could be problematic. To address these concerns, the Legislature could deposit revenues from an individual mandate penalty or sugary drink tax in the General Fund, and then use General Fund dollars to pay for affordability policies. This would allow new revenues to substantially fund affordability proposals, while avoiding conflicting policy and fiscal goals and allowing the Legislature more flexibility to structure affordability policies.

Options for Funding Affordability Policies

(Continued)

Potential for Savings From Increased Efficiency in Health Care Delivery System Over the Long Term

- ***Broad Concerns Have Been Raised About Health Care Costs and Access.*** The Legislature, among others, has raised concerns about underlying costs, efficiency, and access in the state's overall health care system.

- ***Legislature Has Taken Recent Actions Related to Broader Concerns About Underlying Costs.*** As part of the 2018-19 budget package, the Legislature set in motion two ongoing, multiyear efforts that are intended to explore issues related to broader concerns about underlying costs in the state's health care system. Specifically, the Legislature provided funding to the Office of Statewide Health Planning and Development to begin planning and developing a database that would collect information on public and private health care costs and utilization in the state. The Legislature also established a Council on Health Care Delivery Systems that will develop options for structural reforms to the state's health care delivery system to accomplish universal health care coverage and reduced health care costs.

- ***Timing and Magnitude of Potential State Savings Very Uncertain.*** The state's health care system is complex—numerous factors influence cost and efficiency. The efforts identified above will take time to develop and implement. To the extent that efficiencies are identified, it is possible that state's health care costs (such as for employee health benefits or in Medi-Cal) could decrease, freeing up resources for a variety of priorities. However, the timing and magnitude of any potential savings are very uncertain.

Implementation Considerations

Options for Implementing Premium Assistance

- ***Refundable, Advanceable Tax Credit.*** The Legislature could provide a tax credit modeled after the federal Advanced Premium Tax Credit (APTC). Covered California would estimate how much assistance a household would be eligible for prior to enrollment. Households could choose to "advance" a portion of the credit to insurers up front, to immediately reduce monthly premiums. Advanced credit amounts would be reconciled at year's end through a household's income tax filing. The credit would be refundable, such that if the amount of the credit exceeds a household's tax bill, the difference would be received as a tax refund.

- ***Refundable, Non-Advanceable Tax Credit.*** Alternatively, the Legislature could provide a refundable tax credit that would not be advanceable. Instead, the full value of the credit would be claimed through a household's income tax filing.

- ***Up-Front Premium Subsidy.*** Other states with individual market premium subsidies do not provide them through a tax credit. Instead, the full value of the subsidy is provided to insurers up front to immediately reduce a household's monthly premiums, with no later reconciliation through the tax system.

Implementation Considerations

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Premium Assistance Options Have Varying Implications

These options would have varying impacts on administrative complexity, program integrity, and new enrollment in coverage, and therefore trade-offs that the Legislature would need to weigh to see which options align best with its priorities. For example, some options are more administratively complex than other options, while having a relatively greater impact on new enrollment in health coverage.

Refundable, Advanceable Tax Credit

- ***Implications for Administrative Complexity.*** Establishing premium assistance modeled after the APTC would involve new workload for Covered California to estimate subsidies, advance assistance to insurers, and process updates to the amount of advanced assistance received throughout the year. Existing APTC processes could likely be leveraged for this workload. This option would also involve significant new responsibilities for FTB and would require extensive coordination among agencies.

- ***Implications for Program Integrity.*** Income and other household information relevant for determining the amount of assistance a household could receive could likely be verified using the same electronic data sources used for the APTC. As with the APTC, the amount of state assistance advanced through the year could be adjusted in response to changes in household circumstances. The final amount of assistance would be tied to income and other household information as reported through state income tax filings.

- ***Implications for New Enrollment in Health Coverage.*** By reducing the effective cost of coverage, providing additional state premium assistance is likely to cause some households to enroll in health insurance coverage that they otherwise would not have. Modeling state premium assistance on the APTC would allow premiums to be reduced up front, so that consumers would benefit from new assistance immediately. This would likely lead to a relatively greater impact on new enrollment.

Implementation Considerations

(Continued)

Refundable, Non-Advanceable Tax Credit

- ***Implications for Administrative Complexity.*** Because assistance would not be advanced, Covered California would not necessarily have workload associated with estimating the amount of assistance prior to enrollment and would not advance assistance to insurers. Covered California could potentially have other responsibilities related to certifying a household's enrollment in coverage that would qualify the household for the credit. This option would also result in significant new responsibilities for FTB. However, the lack of the advanceable component could make these less extensive than in an option modeled after the APTC.

- ***Implications for Program Integrity.*** Like the APTC, the amount of assistance would be tied to income and other household information as reported through state income tax filings.

- ***Implications for New Enrollment in Health Coverage.*** Because assistance would be provided in a lump sum after the end of the year, a household's premiums would not be reduced up front to reflect the premium assistance. This would likely lead to relatively a smaller impact on new enrollment in health coverage than an option that provides premium assistance up front.

Implementation Considerations

(Continued)

Up-Front Premium Subsidy

- ***Implications for Administrative Complexity.*** Similar to state premium assistance modeled after the APTC, this option would involve new workload for Covered California to estimate subsidies, advance assistance to insurers, and process updates to the amount of advanced assistance received throughout the year. Existing APTC processes could likely be leveraged for this workload. This option would not result in new responsibilities of workload for FTB.

- ***Implications for Program Integrity.*** Similar to state premium assistance modeled on the APTC, income and other household information relevant for determining the amount of assistance a household could receive could likely be verified using the same electronic data sources used for the APTC. The amount of state assistance advanced through the year could be adjusted in response to changes in household circumstances. Unlike state premium assistance modeled on the APTC, the amount of assistance would not be tied to income and other information report through tax filings. In some cases, this could result in some households receiving more or less assistance than they would have under a tax credit option.

- ***Implications for New Enrollment in Health Coverage.*** Because premiums would be reduced up front, consumers would benefit from new assistance immediately and would be more likely to newly enroll in coverage. Accordingly, this option could have a relatively greater impact on new enrollment.

Implementation Considerations

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Legislative Guidance Would Be Needed on Desired Level of Enforcement of Individual Mandate by FTB

- How FTB would administer a state individual mandate, and at what cost to the state, will significantly depend on what level of enforcement the Legislature desires.

- Stronger enforcement of a state mandate would likely require enhanced coordination and data-sharing among agencies and additional resources for FTB to review tax filings. Increased enforcement could also increase the deterrent effect of the mandate.

- If the Legislature proceeds with a state individual mandate, it will be important to consider the benefits of additional enforcement against its costs.