

### ESTIMATING THE “HIDDEN TAX” ON INSURED CALIFORNIANS DUE TO THE CARE NEEDED AND RECEIVED BY THE UNINSURED

By Len M. Nichols and Peter Harbage

The report released today by the Hoover Institution confirms that insured families across California pay a “hidden tax” to provide uncompensated health care to the uninsured. The existence of this “hidden tax” is no longer in dispute; what’s under debate is its magnitude, which is hard to measure precisely because it is “hidden.” This memo describes the range of estimates that various experts have made, highlights some of the reasons for differing judgments, and then lets the reader draw his or her own conclusions about the reasonable range of hidden tax estimates.

#### Previous Estimates

- **Families USA: 10.6% hidden tax.** In 2005, Professor Ken Thorpe of Emory University, in a report written for Families USA, a national consumer advocacy group, found that cost-shifting nationally accounts for 8.5 percent of premiums. Taking into account factors unique to California (more uninsured than average, lower Medi-Cal payment rates), he found that cost-shifting raises the premiums of Californians with insurance by 10.6%, a rate he predicts will stay relatively constant through 2010. Thorpe found that 12 states have higher hidden tax rates than California, with New Mexico’s rate of 17.8% ranking the highest.<sup>1</sup>
- **The New America Foundation: 9.6% hidden tax.** In a 2006 issue brief, Peter Harbage and Len Nichols of the New America Foundation estimated that costs shifted from the uninsured result in Californians paying roughly 10% more for their private insurance premiums.<sup>2</sup>
- **Institute for Health Policy Solutions: 5–6% hidden tax.** In 2006, Rick Curtis of the Institute for Health Policy Solutions, writing for the non-profit, non-partisan California HealthCare Foundation, found that the hidden tax in California is between 5% and 6% of private health insurance premiums.<sup>3</sup>
- **Hoover Institution. In 2007,** John Cogan *et al* estimated that “at most” the hidden tax is 2.8%.

<sup>1</sup> Families USA, *Paying a Premium: The Added Cost of Care for the Uninsured*, June 2005.

<sup>2</sup> Peter Harbage and Len Nichols, *A Premium Price: The Hidden Costs All Californians Pay in Our Fragmented Health Care System*, December 2006, available at: <http://www.newamerica.net/files/HealthIBNo3.pdf>.

<sup>3</sup> Institute for Health Policy Solutions, *Covering California’s Uninsured: Three Practical Options*, California HealthCare Foundation, October 2006.

## How should the hidden tax be estimated, and what choices must be made?

There are many steps in estimating the “hidden tax,” including estimating: (1) the number of the uninsured; (2) the amount of care used by each uninsured person; (3) the amount of care that the uninsured pay for themselves out-of-pocket; (4) the amount of care that government and philanthropy pay for through indirect funding; (5) the private spending “base” onto which at least some of the uncompensated cost may be shifted; and (6) how much of the uncompensated cost providers shift to premiums. We discuss each in turn, showing how the “hidden tax rate” can vary depending on each assumption.

### *Number of the uninsured*

The first basic question to be answered is, how many people are uninsured, or what fraction of the population is uninsured?

The Hoover Institute paper incorrectly suggests that New America miscounted the number of uninsured. The study correctly suggests that the appropriate concept to measure is the “full-year equivalent” number of uninsured. Someone who is uninsured for the full year is counted as one uninsured person, and someone who is uninsured for only part of the year is counted as less than one uninsured person, depending on the duration of uninsurance; for example, someone who is uninsured for half of the year is counted as 0.5 uninsured persons.

The U.S. Census Bureau’s Current Population Survey (CPS) captures this “full-year equivalent” concept.<sup>4</sup> Researchers agree that the CPS measures the number of uninsured at the time of the survey. This number is the “full-year equivalent” number of uninsured, because the survey could conceivably yield the same number at *every* point in time throughout the year, and an annual number would be the average of all of those point estimates. In 2005, the CPS reported that 6.8 million Californians (18.8% of the total population, 20.7% of the non-elderly population) were uninsured.<sup>5</sup>

In our original issue brief, we in fact used the “full-year equivalent” number of uninsured to calculate the hidden tax. As documented in footnote 8, we used a percentage of the uninsured (20%) that approximated the percentage of the uninsured reported by the CPS.<sup>6</sup> On the first page of the brief in describing the issue, we cited an estimate from the California Health Interview Survey (CHIS) of the number of uninsured for both the full year and for part of the year, because that estimate is familiar in California policy debates.<sup>7</sup> We regret any confusion caused by a mismatch between our descriptive citation and our analytic calculation. However, our estimate of the hidden tax did use the “full-year equivalent” number of uninsured from the CPS.

### *Amount of care used by the uninsured*

On average, uninsured people use far less care than insured people do, mostly because they face the full price of care at the outset. In this case, the assumptions by the New America study and the Hoover Institution study differ little: New America assumes that the uninsured use 40% of the care of the insured, based on

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<sup>4</sup> Economic Research Initiative on the Uninsured, *How many are uninsured?*, available at: <http://www.umich.edu/~eriu/highlight-fastfacts.html>, accessed May 16, 2007.

<sup>5</sup> U.S. Census Bureau, Current Population Survey, 1988 to 2006 Annual Social and Economic Supplements. In March 2007, CPS revised its health insurance data; using the CPS Table Creator, there were 6.8 million uninsured Californians in 2005.

<sup>6</sup> See footnote 8 in our original issue brief, *supra* note 2.

<sup>7</sup> The CHIS “full-year equivalent” number of uninsured was 4.9 million in 2005. Thus, using this survey, as the Hoover Institution does, results in a 30% differential in estimates of the hidden tax. We chose to use the CPS because it has a higher response rate than the CHIS. See C. L. Schur et al., *California’s Uninsured and Medi-Cal Populations: A Policy Guide to the Estimates*, California Healthcare Foundation, January 2004; CHIS 2005 Methodology Series, Report 4: Response Rates.

analytic estimates done by the UCLA Center for Health Policy Research,<sup>8</sup> while Hoover assumes that the uninsured use 50% of the care of the insured, based on work done by researchers at the Urban Institute.<sup>9</sup> Because an assumption that the uninsured use more care would yield a higher estimate of the hidden tax, New America was conservative in its assumption.

*Amount of care paid for by the uninsured out-of-pocket*

Both New America and the Hoover Institution assume that the uninsured pay for 40% of their care on average, based on the same work by the UCLA Center for Health Policy Research. Therefore, the choice of assumption here does not explain the difference between our estimates.

*Amount of care paid for by the government and philanthropy*

As the original New America study notes, funding by federal, state, and local governments may help defray the cost of uncompensated care for the uninsured. The largest single component of this funding is the disproportionate share hospital (DSH) payments made by Medi-Cal. The amount of all indirect funding is itself difficult to estimate; one study by the UCLA Center for Health Policy Research estimates indirect government subsidies of \$3.6 billion in 2005,<sup>10</sup> an estimate used by the Hoover Institution, but another study by Families USA estimates government funding of only \$1.7 billion.<sup>11</sup> New America estimated that roughly \$2 billion in indirect funding might go toward care for the uninsured in California.

Beyond the size of indirect funding, the main question is how much of that money goes toward care of the uninsured, as opposed to making up for payment shortfalls on behalf of the publicly insured. We discussed this issue at some length in our original issue brief. The Holahan and Hadley paper cited by Hoover (and by New America in its original issue brief) implied that the vast majority of indirect funding does indeed go toward care for the uninsured *in the nation as a whole*—an assumption that those researchers are rethinking as we write this.

But this assumption should certainly not be applied to California, where Medi-Cal pays lower rates than most other state Medicaid programs. In fact, Medi-Cal payment rates are so low that the Governor's own reform plan includes \$4 billion in funding just for Medi-Cal payment rate increases. This implies a payment shortfall that is *larger* than Hoover's estimate of total current government funding, all of which Hoover assumes is going toward care for the uninsured.

We certainly agree that the question of how much government funding actually offsets uncompensated care for the uninsured is a difficult one to answer empirically. To illustrate the importance of this question in estimating the hidden tax, we have estimated the hidden tax using various assumptions about the percentage of government funding that goes toward care for the uninsured. If the entire \$3.6 billion (in 2005 dollars) assumed by Hoover defrays uncompensated care for the uninsured, the hidden tax rate falls to 5.9%. If half goes toward care for the uninsured and half goes toward the Medi-Cal underpayment, then the rate rises to 8.5%. If only 25% goes toward care for the uninsured and 75% goes toward Medi-Cal underpayment, the hidden tax rate rises to 9.8%.

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<sup>8</sup> Gerald F. Kominski, Dylan H. Roby, and Jennifer R. Kincheloe, *Cost of Insuring California's Uninsured*, UCLA Center for Health Policy Research Brief, May 2005.

<sup>9</sup> Jack Hadley and John Holahan, *How Much Medical Care Do The Uninsured Use, And Who Pays For It?* Health Affairs, 12 February 2003.

<sup>10</sup> UCLA, *supra* note 10.

<sup>11</sup> Families USA, *supra* note 1.

Note that even using the assumption chosen by the Hoover Institution—100% of indirect subsidies go toward care for the uninsured – the hidden tax rate on private premiums is still substantial at nearly 6%. More subtly, the “full” hidden tax is still over 10%—it is just partially paid by taxpayers to fund indirect government subsidies, instead of by the insured through premium increases. The larger point of our work is that we all help pay for the uninsured in a variety of ways today. In our view, we should try to pay for them more efficiently and transparently, by covering everyone and demanding personal responsibility in return.

*Private spending base onto which uncompensated care costs are shifted*

National Health Account data report that nationally, private payers paid for 55% of health care costs in 2005, and that is the “base” number we used in our original paper.<sup>12</sup> Assuming that the vast majority of government funding goes toward Medi-Cal underpayment, the hidden tax rate using this base is 9.6%.

However, further thought suggests that using this base was too conservative. First, out-of-pocket payments by Medicare beneficiaries cannot be increased to compensate for the cost of the uninsured, since Medicare prices are fixed by the program. Second, private philanthropy is not affected by care prices. Therefore, both Medicare out-of-pocket spending and philanthropy should not be included in private spending as sources that could pay more for the cost of the uninsured. Using this corrected lower base, and again assuming that the vast majority of government funding goes toward Medi-Cal underpayment, the hidden tax rate is actually 11.1%.

*How much of the cost of uncompensated care is shifted to premiums?*

Finally, there is the question of how much uncompensated care providers are able to shift to private payers by charging them higher prices. If providers would lose too much business by charging higher prices, they may be forced to bear some of the burden of uncompensated care. While it is probably true that some providers are not able to shift *all* of the cost of uncompensated care to payers, it seems likely that they do shift a large portion; otherwise, they would find it hard to keep the doors open for the uninsured, which most hospitals and many doctors do. We simply note, however, that if providers “swallow” some uncompensated care, the magnitude of the hidden tax borne by society is not lower; it is just partially borne by providers, instead of being shifted entirely to insured patients. Again, the larger lesson is that we all pay for the uninsured in many ways today.

*Summary*

The following chart summarizes our findings. Our bottom line conclusion: Unless one assumes that (1) the Census Bureau overstates the number of uninsured Californians by 2 million, *and* that (2) none of the indirect government subsidies flowing to providers help make up for the Medi-Cal underpayment, a reasonable estimate of the hidden tax ranges from 6%—11%. The reality is very likely in that range, and roughly 10% remains our best estimate. We all pay for the uninsured today, and we ought to reorganize our system to cover them and spend our health care dollars more wisely.

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<sup>12</sup> Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group.

## Summary of Calculations of Hidden Tax Rates on the Insured from Care Delivered to the Uninsured

	NAF Original	NAF Best Estimate Today	IF CHIS Estimate of Uninsured is Correct	IF CHIS Estimate of Uninsured is Correct and All of Indirect Moneys Pay for Uninsured	IF CPS Estimate of Uninsured is Correct and All of Indirect Moneys Pay for Uninsured	If Half Of Indirect Moneys Pay for Uninsured (Rest Goes Toward Medi-Cal Underpayment)	If 25% Of Indirect Moneys Pay for Uninsured (Rest Goes Toward Medi-Cal Underpayment)
<b>Percent Uninsured</b>	20%	18.8%	13.4%	13.4%	18.8%	18.8%	18.8%
<b>Percent of Care Uninsured get vs. Insured</b>	40%	40%	40%	40%	40%	40%	40%
<b>Percent of Care Paid for Out of Pocket by Uninsured</b>	40%	40%	40%	40%	40%	40%	40%
<b>Percent of Total Care which Uninsured get that Must be Financed Elsewhere</b>	4.8% <sup>i</sup>	4.5%	3.2%	1.2% <sup>ii</sup>	2.5%	3.5% <sup>iii</sup>	4% <sup>iv</sup>
<b>Percent of Health Spending of Private Sector "Base," to which Uncompensated Care Costs Might be Shifted</b>	55%	45% <sup>v</sup>	45%	45%	45%	45%	45%
<b>Estimated Hidden Tax Rate, Percent by which Private Prices and Premiums are Increased due to Care Delivered to the Uninsured</b>	9.6% <sup>vi</sup>	11.1%	7.7%	2.7%	5.9%	8.5%	9.8%

<sup>i</sup> 4.8% = (.2\*.4\*(1 - .4))

<sup>ii</sup> 1.2% = 3.2% - 2.0% (2% = 3.6/179.1, share of total personal health spending in CA in 2005)

<sup>iii</sup> 3.6% = 4.5% - 1.0%

<sup>iv</sup> 4.1% = 5.0% - 1.0%

<sup>v</sup> 45% = 50.9% (share that personal out of pocket (OOP) and private health insurance (PHI) comprise) - 5.9% (share of total \$ from elderly OOP)

<sup>vi</sup> 9.6% = 4.8 / (55 - 4.8) [because current premiums include cost shift, the cost shift must first be subtracted out of the base]