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THE CATASTROPHIC HEALTH TAX ON AMERICA'S ELDERLY

INTRODUCTION

Legislation now pending in the House and the Senate would expand Medicare to provide catastrophic health coverage for the elderly. The problem is that the bills would fund the new benefits through a massive additional income tax exclusively on the elderly, together with a flat rate increase in Medicare premiums. The Treasury Department projects that the additional income tax burden would eventually be as high as $8,000 per year for an elderly couple and $4,000 for widows and widowers, besides substantial increases of hundreds of dollars per year in Medicare premiums. Under the Senate bill, senior citizens would be hit with an income tax surcharge of as much as 16 percent of their current income tax liability. While the marginal tax rates of non-elderly Americans will continue to be indexed, moreover, marginal tax rates for the elderly would increase each year under the legislation to keep pace with unlimited benefit expenditures.

The total income tax hike on the elderly would amount initially to $5 billion per year, rising to as much as $35 billion over the first five full years of the catastrophic care program. The Treasury estimates that ten years later the total extra tax burden on the elderly would exceed $40 billion per year, or $20 billion in today's dollars.

Long-Term Care Missing. Yet despite this enormous income tax burden, elderly Americans would not, under either the House or Senate bill, receive coverage against the biggest financial threat associated with ill health. The real catastrophic health care cost problem for the elderly is long-term care in nursing homes. But the proposed legislation would not provide any coverage for such long-term care expenses, nor do anything to encourage the development or purchase of private long-term care insurance.

For most retired Americans, in fact, the main effect of the legislation would be to force them to give up the private catastrophic coverage they now have and instead pay heavy taxes for similar services through Medicare. The vast majority of the elderly already have, through the private sector, the main benefits contained in both bills--coverage for acute care provided by hospitals and physicians for a specific illness or medical problem. Indeed, millions of elderly Americans now receive such coverage at no charge through health benefits under their company pensions or through health maintenance organizations. Under the proposed legislation, these retirees could end up paying thousands of dollars in new income taxes for coverage they now receive free of charge. Moreover, the House bill includes costly outpatient prescription drug coverage that would provide no real catastrophic protection for most of the elderly.

Even without the drug benefits, the Treasury Department estimates the cost of the House bill at $70 billion per year by 2005, or about $35 billion in constant 1988 dollars. The Senate bill would increase spending by $5.2 billion in 1990 and $37.4 billion per year over 1990-1994. By 2005, the Senate bill is projected to cost $64.4 billion, or almost $32 billion in 1988 dollars. As the Treasury points out, these costs far outstrip the enormous tax hikes planned by Congress, leaving a gap of at least $20 billion annually in current dollars.

AIDS Drugs. The drug benefits in the House bill could almost double the cost. And these cost figures take only scant account of developments that could increase significantly the total price tag of the program. Expensive advances in technology and a greater willingness of physicians and hospitals to prescribe costly services, for example, could add billions of dollars that will have to be paid for through taxes on America's senior citizens. Even the AIDS crisis could cast a deep shadow over elderly taxpayers, since an unknown number of non-elderly AIDS sufferers could be eligible for drug therapy under the catastrophic care program.

Elderly Americans deserve to be informed by Congress about the content and true cost of this legislation. Many senior citizens support the legislation in the mistaken belief that it will remove all their health care financial worries. Yet if the legislation is passed in its current form, they will find themselves victims of a cruel bait-and-switch game in which they could still face financial ruin through ill health yet pay far higher taxes.

THE CATASTROPHIC HEALTH LEGISLATION

Under existing law, Medicare comprises two forms of financial aid for medical costs. Medicare Part A (Hospital Insurance or HI) now pays for up to 90 days of inpatient hospital care for each spell of illness, plus 60 additional "lifetime reserve days" of additional hospital care for the life of each beneficiary. This coverage is subject to a deductible of $520 per hospital stay, plus co-insurance fees of $130 per day for the 61st to 90th days of hospital stay, and $260 for each lifetime reserve day. In addition, Part A pays for up to 100 days of care per spell of illness in a skilled nursing facility, with a daily co-insurance fee of $65 after 20 days. Part A also contributes to the cost of home health care and hospital care. Part A coverage is financed through a portion of the Social Security tax, which includes a mandatory earmarked HI payroll tax rate of 1.45 percent each on the employer and the employee.

Medicare Part B (Supplementary Medical Insurance or SMI) pays for physician or other health related services--but not outpatient prescription drugs. This coverage is subject to an annual deductible of $75 and co-insurance fees equal to 20 percent of the approved charges. This coverage is financed by a voluntary monthly premium of $17.90, or about $215 per year, payed by each elderly beneficiary. Well over 90 percent of the elderly are enrolled in Part B. The premium, however, covers only 25 percent of program costs; general revenues finance the remaining 75 percent. Both the Part B monthly premium and the Part A deductible and co-insurance fees are indexed to increases in health care costs.

The House Bill

The Benefits: In the House, catastrophic health care legislation (H.R. 2470), co-sponsored by Fortney "Pete" Stark, the California Democrat, and Willis Gradison, the Ohio Republican, has been approved by committee and is ready for a floor vote. The bill would provide for an unlimited number of days of hospital coverage under Medicare and the elimination of the current co-insurance fees which apply after 60 days. The deductible of $520 for in-hospital care would be applied only once per year (rather than for each spell of illness under current law), regardless of the number of hospital check-ins. Under the legislation, the deductible also would increase only with the general rate of inflation, rather than with the index of health costs.

The deductible and co-insurance fees under Part B would be subject under the House bill to an annual cap of $1,043, indexed for general inflation. Coverage for skilled nursing facility services would be expanded to 150 days per year, with a co-insurance fee estimated at $24 per day in 1988 (tied to rising daily facility charges). The fee, however, would apply only for the first seven days. In addition, Medicare would also cover outpatient prescription drugs, subject to a $500 annual deductible indexed to inflation and a 20 percent co-insurance fee. Coverage would be expanded for home health care services, hospice care, and outpatient mental health services.

The Cost to the Elderly: This increased spending would be financed mainly by a huge income tax increase on the elderly--euphemistically called a "mandatory supplemental premium." This would apply to all Medicare beneficiaries, whether or not they are enrolled in Part B. In addition, all retirees enrolled in Part B would face a flat rate premium increase to cover the balance of cost. Lawmakers argue that this Part B premium increase is not a tax because Part B is voluntary. But for a retiree to avoid this "voluntary" hike in Medicare costs, he or she would have to give up all the Part B services now received. Few elderly Americans would see that as much of a free choice.

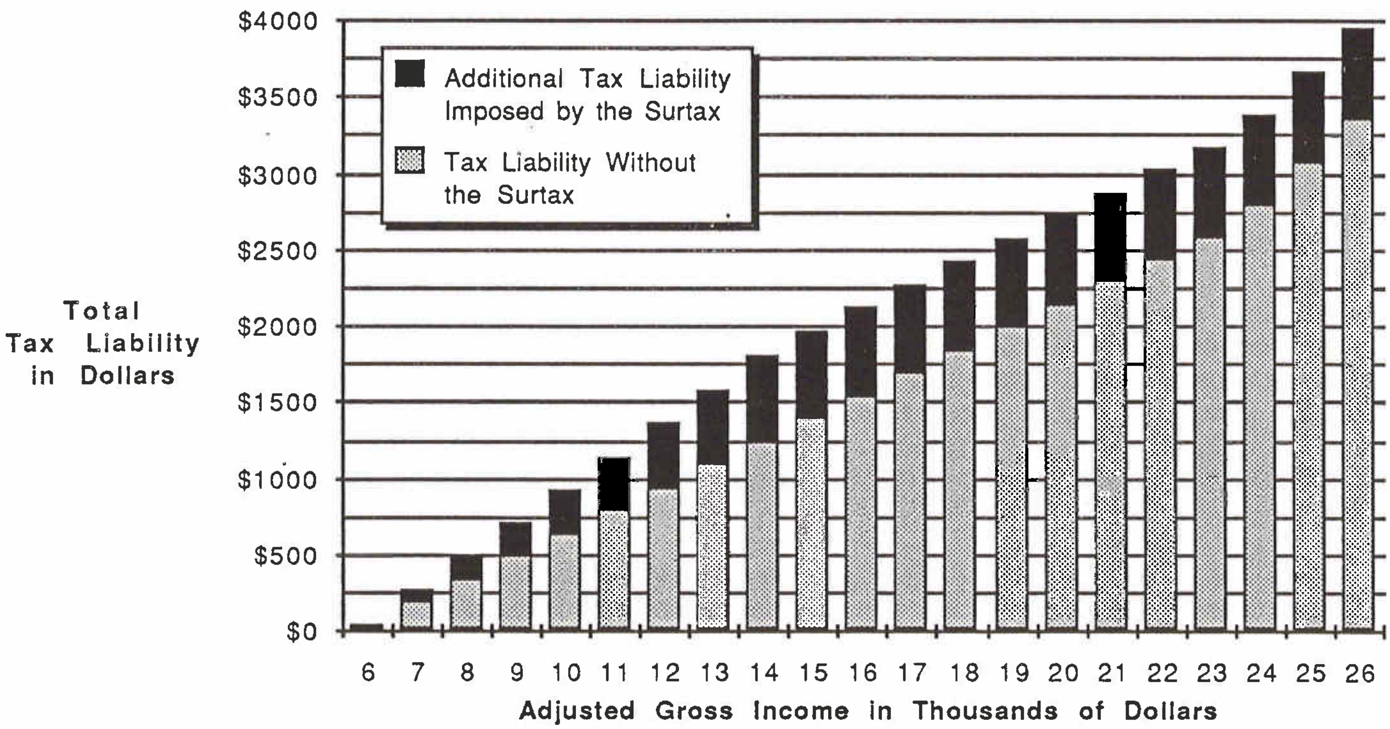
The new health tax would start at an adjusted gross income of just $6,000 per year. The tax would climb to a maximum of $580 per year for single elderly persons at $14,166 in income and to $1,160 per year for an elderly couple at $28,332 in income (see Figures 1 and 2). The tax would be in addition to their regular income tax payments. The new tax, moreover, would increase every year to keep pace with the costs of the new Medicare expenditures. By 1992, the maximum supplemental tax is projected at $958 for a single elderly person and $1,916 for an

Figure 1

How the House Bill Will Increase Taxes for Widows and Widowers in 1988

Tax on Elderly Singles

(In 1988 Dollars)



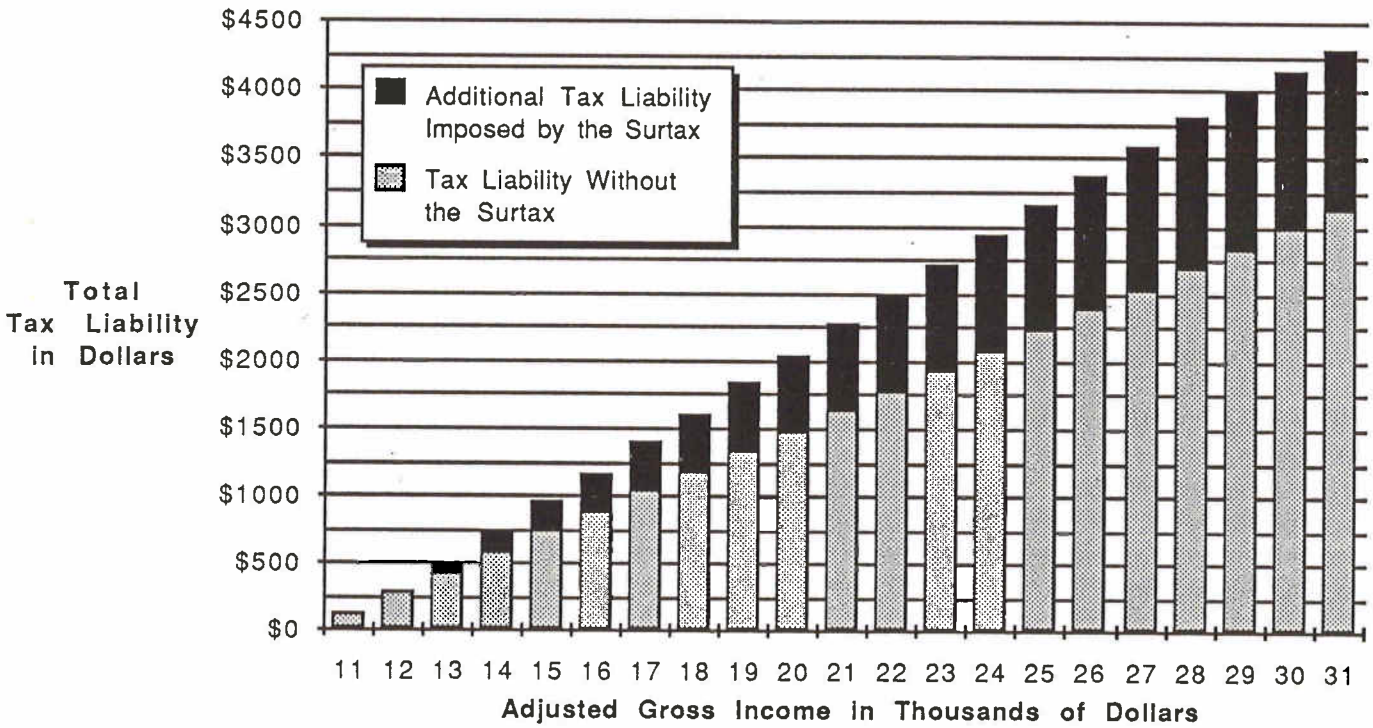
Note: For purposes of calculating tax liabilities in figures 1 through 5, taxable income is assumed to be adjusted gross income minus the applicable standard deduction and personal exemption(s). No other exemptions, deductions or credits are assumed.

Figure 2

How the House Bill Will Increase Taxes for Grandparents in 1988

Tax on Elderly Couples

(In 1988 Dollars)



elderly couple (see Figures 3 and 4). The Treasury Department estimates that 13 years later the maximum supplemental tax would be between $3,000 and $4,000 for a single elderly American and $6,000 to $8,000 for an elderly couple, in constant 1988 dollars.[1]

Moreover, even low-income elderly Americans would be forced to pick up the tab for the catastrophic care program, because in addition to the tax on the elderly, Congress intends to fund part of the benefits through a hike in the regular monthly Part B premium paid by almost all Medicare beneficiaries. Under current law, the regular Medicare Part B monthly premium, which is adjusted in line with health costs, is already expected by 1992 to rise to $26 per month. But the Department of Health and Human Services (HHS) estimates that for the new benefits not paid for by the tax hike to be financed by the regular Part B premium could require an additional increase of more than $22 per month by 1992, or $264 per year, on top of the increase expected under current law. This would result in a total monthly premium in that year of $48 per month, or $576 per year. These flat-rate premium increases, which would apply to all retirees enrolled in Part B, regardless of income, would be in addition to the income tax increases envisioned by Congress.

The Senate Bill

The Benefits: In the Senate, legislation (S. 1127) sponsored by Lloyd Bentsen, the Texas Democrat, has also been approved by committee and awaits a floor vote. The bill would provide for benefits similar to those contained in the House legislation, except that there would be no new coverage for outpatient drugs and a single cap of $1,700 per year on combined Part A and Part B out-of-pocket expenses, indexed to general inflation.

The Cost to the Elderly: To finance this new spending, the Senate bill would impose an income tax surcharge on the elderly enrolled in Part B (that is, a tax on tax) of 8 percent of their income tax liability above $150 per year for single persons, 16 percent for married couples. The resulting tax surcharge would be subject to an annual cap of $800 for a single person, or $1,600 for an elderly couple, increasing by 1992 to $1,000 for a single person and $2,000 for a couple. But these taxes and the cap would continue to increase each year to cover the growth in the new Medicare expenditures. The Senate bill would also impose a flat $4 per month increase in the regular Medicare Part B premium, with further increases over time to keep pace with the added expenses under the bill.

THE CATASTROPHIC TAX HIKE ON AMERICA'S ELDERLY

Under last year's tax reform legislation, Americans below age 65 will soon face a simplified system with much lower marginal rates. Indeed, the whole point of the 1986 tax reform was to reduce marginal tax rates as much as possible. But the proposed catastrophic health legislation would increase marginal tax rates for the elderly above the rates for other Americans. Under the House bill, elderly

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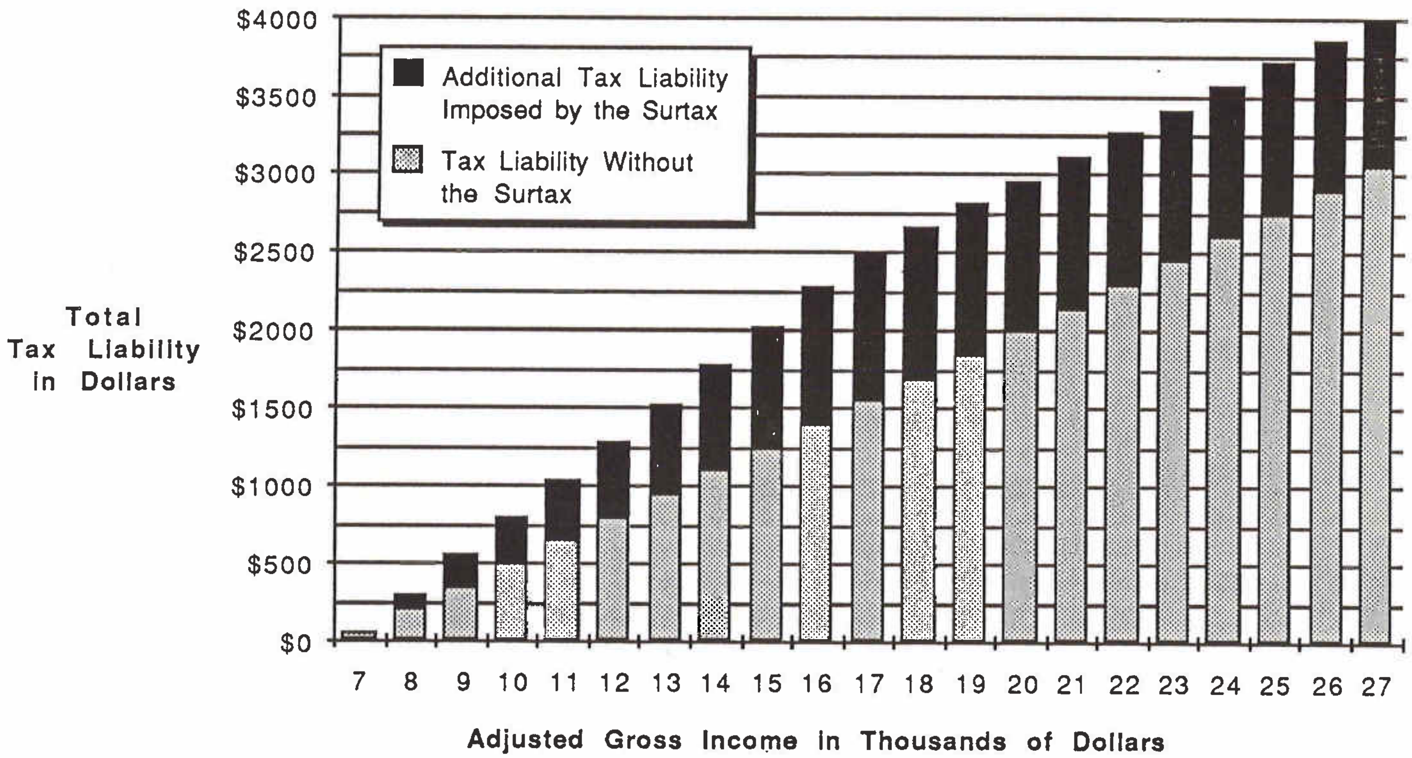
1. Memorandum from Office of Tax Analysis, U.S. Treasury Department, May 21, 1987; Congressional Record E 2262, (daily ed. June 4, 1987).

Figure 3

How the House Bill Will Increase Taxes for Widows and Widowers in 1992

Tax on Elderly Singles

(In 1992 Dollars)



Note: Calculations for figures 3 and 4 are based on CBO projections for the general inflation rate and the Medicare inflation factor, as defined in the bill. The basic income tax brackets, standard deductions, personal exemption and surtax brackets are adjusted according to the general inflation rate. The surtax rates are adjusted according to the Medicare inflation factor.

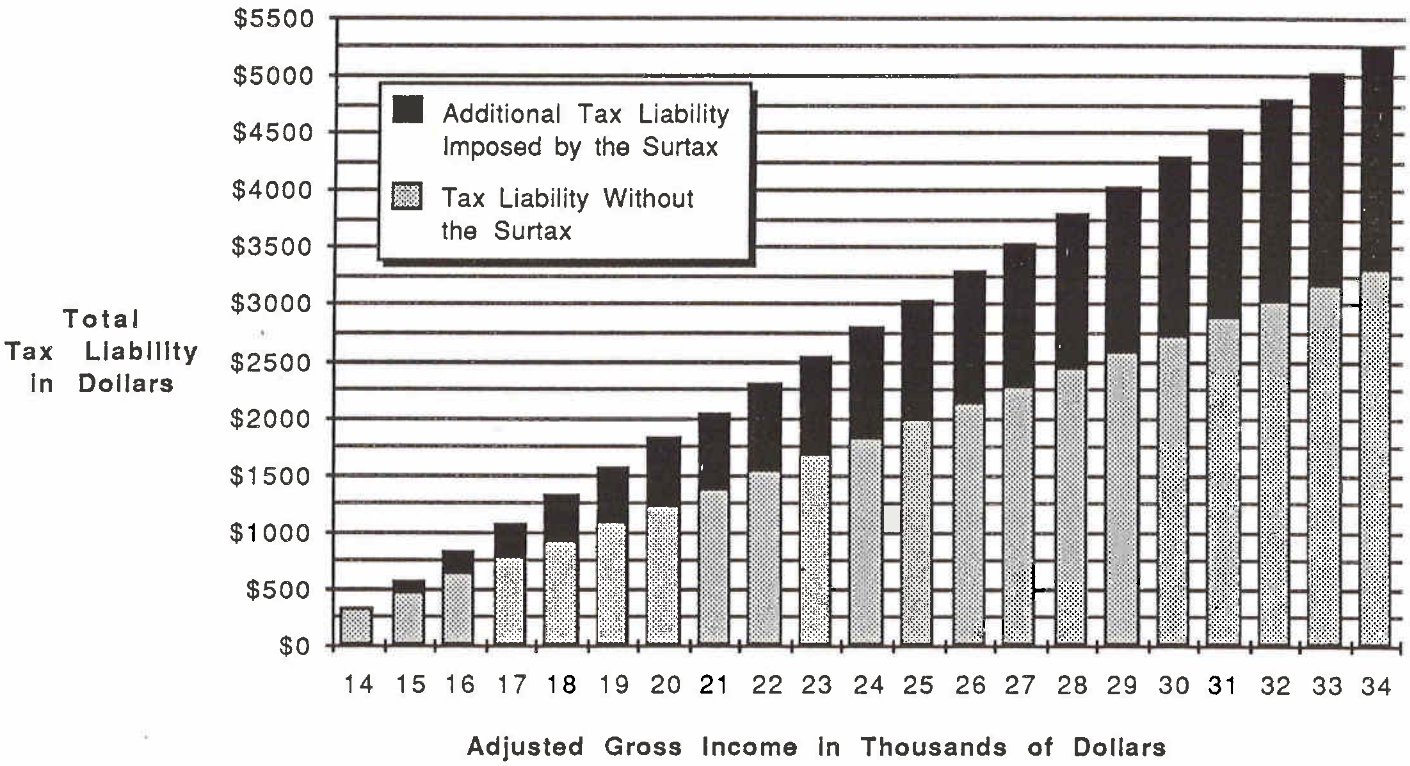
These calculations do not include the 25 percent of the drug provision which will be funded through the surtax. That provision would increase the surtax rates by an additional 5 percent.

Figure 4

How the House Bill Will Increase Taxes for Grandparents in 1992

Tax on Elderly Couples

(In 1992 Dollars)



Americans could not look forward to the new 15 percent marginal tax rate applying to most citizens--they would face a 22 percent effective rate until the cap on the new health tax was reached. Under the Senate bill, the 15 percent marginal tax rate would turn out to be 17.4 percent for married elderly couples; the 28 percent rate for other Americans would be 32.5 percent for the elderly. For single elderly Americans, the 15 percent rate would be increased to 16.2 percent under the Senate bill, and the 28 percent rate would rise to 30.2 percent.

Moreover, marginal tax rates for the elderly would continue to increase each year indefinitely under the legislation, while non-elderly Americans will enjoy constant, indexed tax brackets. The reason: Medicare expenses will likely grow faster than national income indefinitely into the future and the new taxes on the elderly are to be raised to keep pace with these expenses. The Treasury Department estimates that under the House bill an American with income subject to the 15 percent marginal tax rate actually would face, by 1992, a 25 percent rate if he or she is retired.[2]

The result under either bill would be a harsh, discriminatory, added tax burden on the elderly. Millions of elderly Americans would pay hundreds or thousands of dollars in increased income taxes each year. Eventually, the additional income tax burden is projected at as much as $8,000 per year for an elderly couple, in constant 1988 dollars, besides the substantial increases in regular Medicare premiums. The total income tax hike shouldered by the elderly would amount initially to $5 billion per year, rising to a cumulative total of $35 billion over the first five full years of the program. The Treasury Department estimates that, by 2005, the total added income tax burden on the elderly would amount to more than $40 billion per year, or $20 billion per year in constant 1988 dollars.

Extra Taxes on Widows and the Middle Class

It has long been a principle of U.S. tax policy to impose a lower income tax burden on elderly Americans than on the rest of the population. The added tax burden under the catastrophic health legislation would dramatically reverse longstanding policy. Indeed, the elderly would bear a higher income tax burden than other Americans with the same income (see Figure 5). In fact, the entire tax reduction for individuals in the tax reform bill would be taken away from millions of elderly taxpayers under the pending catastrophic legislation.

"Elderly Widow's Tax." The staggering new tax burden would fall primarily on the middle class elderly. Lawmakers found this necessary because there simply are not enough high income elderly people from which to raise the tax revenues needed for the program. In other words, Congress is targeting the middle class for the same reason bank robber Willie Sutton said he targeted the banks--"because that's where the money is." Moreover, the new tax on the elderly would start accruing on single elderly people at lower income levels than on elderly couples. Since most of the single elderly are widows, a substantial portion of the new tax burden can accurately be designated an "Elderly Widow's Tax."

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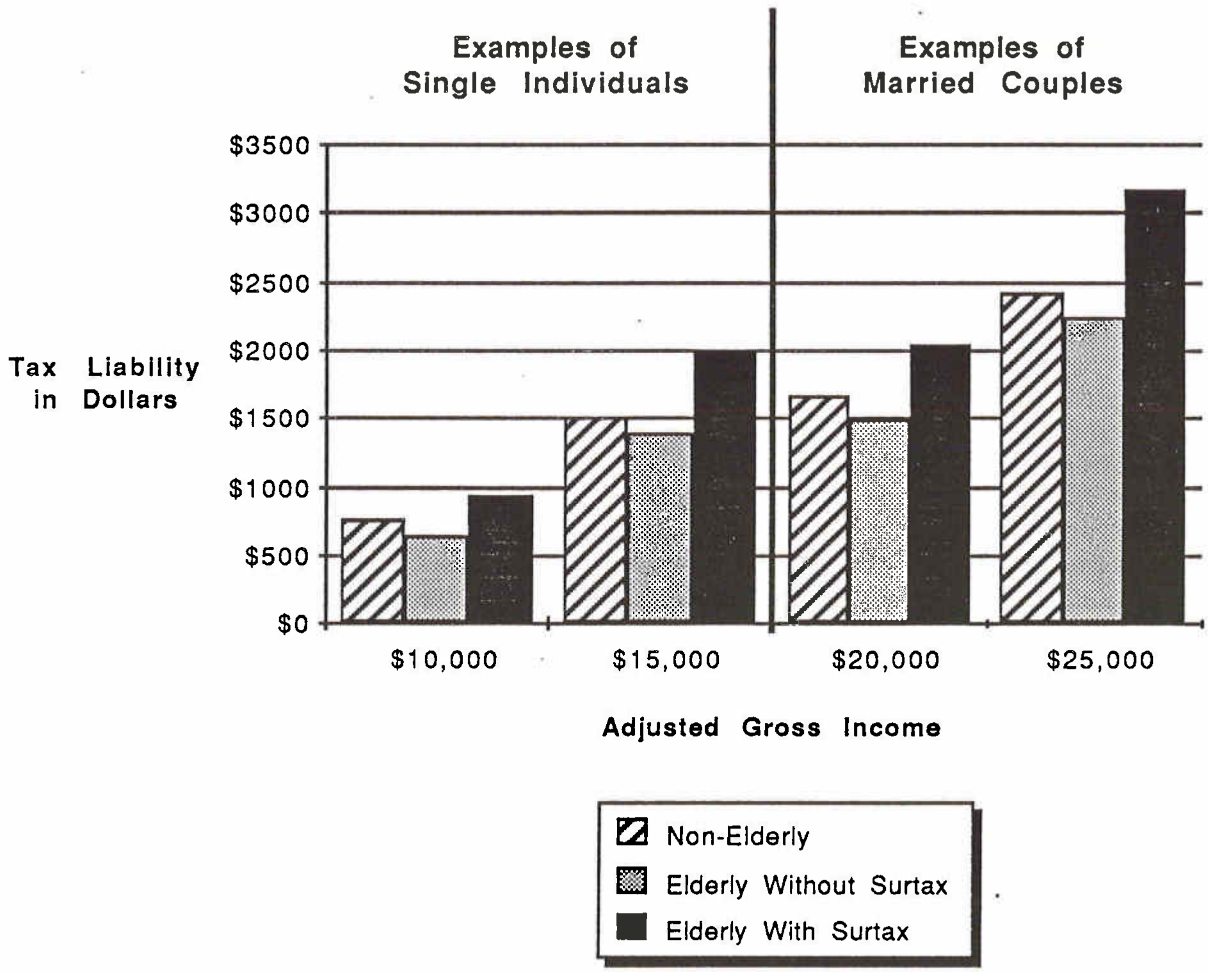
2. Letter to Ways and Means Committee Chairman Dan Rostenkowski from Roger Mentz, Assistant Secretary of the Treasury for Tax Policy, June 23, 1987.

Figure 5

How the Elderly Would Pay Higher Taxes Than the Non-Elderly Because of the Surtax

(Based on House Bill - In 1988 Dollars)



Note: Elderly singles start paying the surtax at $6,001 of AGI, and start paying more in total taxes than non-elderly singles at $7,577 of AGI. Elderly couples start paying the surtax at $12,001 of AGI, and start paying more in total taxes than non-elderly couples at $14,580 of AGI.

Some lawmakers have supported the new taxes in the catastrophic health bills on the mistaken notion that such taxes involve means testing Medicare. This is a serious mistake. Medicare would not be means tested at all under either bill. Under means testing, Americans with higher incomes would receive reduced Medicare benefits. But under the catastrophic health bills, all would receive full Medicare benefits. All that would be means tested is the private incomes of the elderly.

The Explosion in Federal Spending

The catastrophic health legislation would lead to a huge increase in federal spending. In 1990, the first year under the full benefits system of the House bill, including drugs, HHS projects the cost at $12.3 billion. Over the first five full years of the program, the cost would total $85.6 billion. And by 2005, even without drug benefits, the cost would be $70 billion per year, or about $35 billion in constant 1988 dollars. Even the Senate bill would increase spending by $5.2 billion in 1990 and $37.4 billion during 1990-1994. By 2005, the Senate bill is projected to cost $64.4 billion, or about $32 billion in constant 1988 dollars (see Figure 6).

Despite the huge new taxes on the elderly proposed in both bills, revenues are not likely to keep pace with this runaway spending. The Treasury Department estimates that, under the House bill, revenues by 2005 would be sufficient to cover only 70 percent of the added costs, leaving a $20 billion deficit in the program in that year alone. Again, this does not even include the drug provisions of the House bill. Medicare is already projected to run short of promised funds to pay benefits before that time. In fact, to pay all current Medicare benefits promised to today's young workers, current Medicare payroll tax rates would have to raised between 2 and 4 times.[3] Medicare payroll tax rates alone would then be between 50 percent and 100 percent of today's payroll tax rates for all of Social Security and Medicare.

HOW THE BILLS PROVIDE THE WRONG BENEFITS

To compound the folly of this enormous income tax burden, the elderly would receive the wrong benefits under both the House and Senate bills. It is widely agreed that the real catastrophic health care problem for the elderly is long-term care in nursing homes. Such care is very expensive, usually between $1,500 and $3,000 per month, and can soon deplete a patient's entire life savings. Relatives, charity, or Medicaid then must take up the burden. Very few of the elderly have insurance against these expenses, although the insurance industry recently has begun to market such coverage. Yet neither of the proposed bills offers any coverage for such long-term care expenses, nor do the bills do anything to encourage the development or purchase of private long-term care insurance. Typically, elderly Americans are supporting the legislation under the delusion that it will protect them against the financial ravages of long-term illnesses, such as Alzheimer's Disease.

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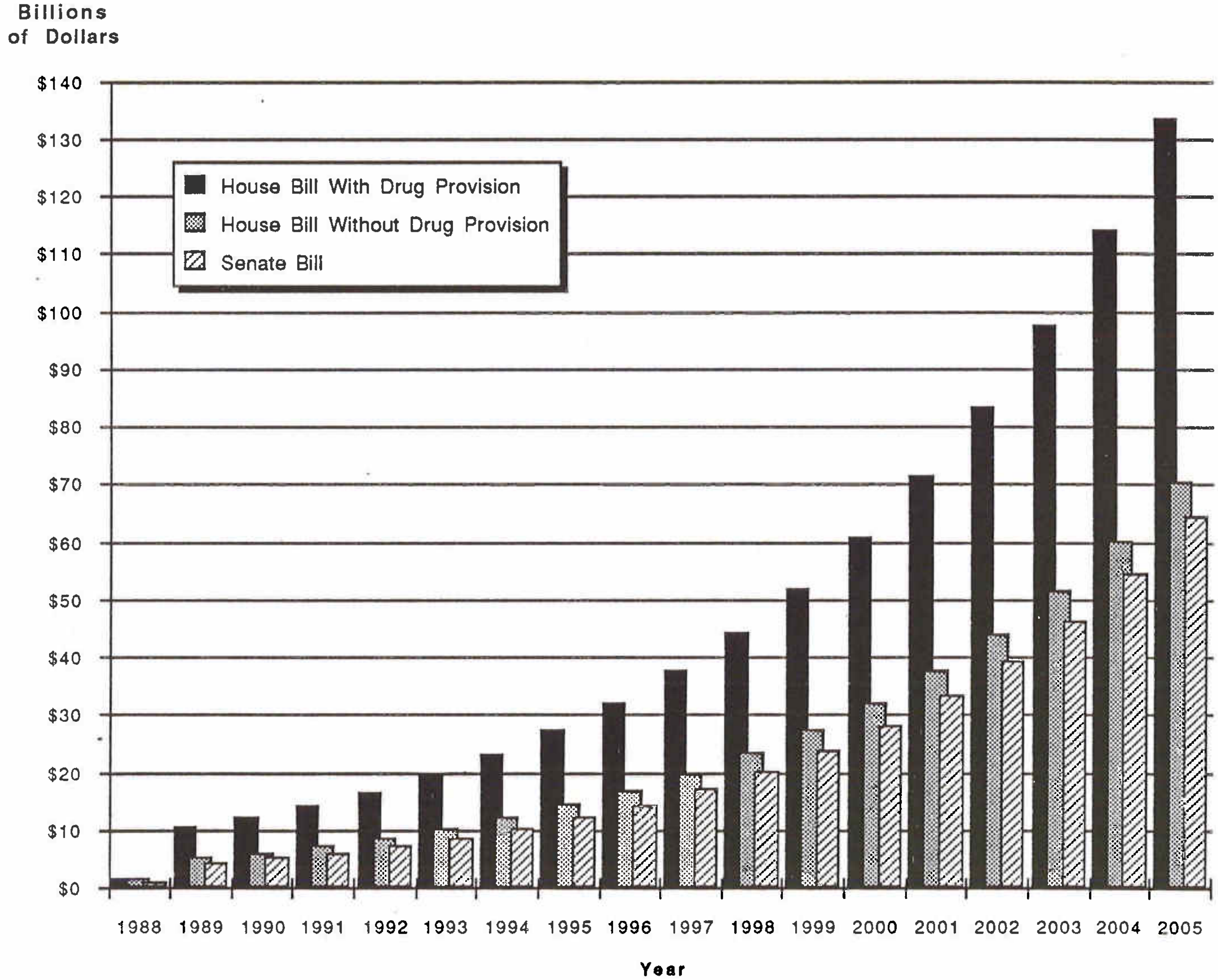
3. See, 1987 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, Washington, D.C., March 30, 1987, Appendix E.

Figure 6

Projected Annual Costs of Proposed Medicare Add-ons

(In Current Dollars)



U.S. Treasury Estimates

Elderly Already Covered. The elderly, in fact, already have the main benefits offered by both the House and Senate bills--catastrophic coverage for acute care in hospitals. About three-fourths of the elderly have such protection through private sector "Medigap" plans. This includes 72 percent of the elderly who either directly purchase such insurance coverage or have it as part of pension benefits provided by their former employers.[4] About 3 percent of the elderly have similar coverage through pre-paid Health Maintenance Organizations (HMOs) under a new government initiative which allows retirees to sign up with an HMO for their Medicare coverage in return for supplemental benefits from the HMO. Medicaid pays for significant medical costs for an additional 10 percent of the elderly.

Millions of these elderly Americans receive this private acute catastrophic care protection without additional charge. Yet they would have to pay hundreds or even thousand of dollars in increased taxes for such coverage under the House and Senate bills. For example, close to one million retirees receive the benefits without charge through the HMO program, where the cost savings resulting from HMOs are used to provide the supplemental benefits. At least another 4 to 5 million retirees receive such coverage from their former employers under pension obligations. The proposed legislation would simply relieve former employers of this responsibility and shift the cost to the elderly themselves in the form of increased taxes. Not surprisingly, several large employers are actively lobbying Congress to pass the proposed catastrophic health bills for precisely this reason.

Moreover, most health related expenses for the elderly currently not met by Medicare or most private insurance would still remain uncovered. In addition to the cost of home care, the remaining gap would include doctors' charges above the fee limits for which Medicare reimbursement (many, if not most, doctors charge more than such limits), dental care, hearing aids, eyeglasses, walking aids, and similar items. These uncovered expenses amount to around 40 percent of all medical costs for the elderly. So the proposed legislation would not, in fact, provide a cap on annual medical expenses for the elderly, as many of the elderly have been led to believe.

THE POTENTIAL DRUG COST EXPLOSION

The House bill, but not the Senate bill, covers one major health cost which is not already covered--outpatient prescription drugs. This insurance coverage is readily available in the private sector, but most of the elderly choose not to buy it--only about 40 percent of the elderly have some private coverage. The main reason for this is that such outpatient drugs do not generally involve catastrophic costs. Yet the House wishes to add this to the tax-financed package.

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4. Institute for Research on the Economics of Taxation, "Catastrophic Health Insurance Is Bad Medicine," Economic Policy Bulletin No. 26, March 18, 1987; Congressional Budget Office; Statement of Nancy M. Gordon, Assistant Director for Human Resources and Community Development, Congressional Budget Office, before the Subcommittee on Health and the Environment, Committee on Energy and Commerce, U.S. House of Representatives, Washington, D.C., March 2, 1986.

Including such drugs in the House bill is likely to stimulate increased utilization of drugs by Medicare beneficiaries. With the government committed to pick up the tab, both doctors and patients would have no concern for costs, and likely would expand substantially the use of expensive and non-essential drugs. But ultimately the elderly would have to pay for this through increased taxes and Medicare premiums all focused on them. This provision in the House bill could double the price tag.

How the Elderly May Foot Part of the AIDS Bill

One real, but seemingly unnoticed danger is that this increased Medicare drug coverage might lead the elderly to pay for most of the highly expensive drug therapy and hospitalization costs of thousands of victims of Acquired Immune Deficiency Syndrome (AIDS). The reason: Americans who contract AIDS and are unable to work qualify for Social Security disability benefits. After two years of receiving such benefits, the AIDS patient also qualifies for Medicare and thus would be covered under the House bill for AIDS drug therapy and for hospital costs. But the disabled and unemployed AIDS patient, who is almost always under 65, would pay little or no extra income taxes for the new catastrophic coverage. This means that the elderly would be paying for the hospitalization and drug needs of some AIDS victims. Of course, most, but not all, AIDS patients currently die before completing the two-year eligibility requirement for Medicare benefits. But that may change with medical advances. In any case, legislation has already been introduced in Congress to eliminate the two-year waiting period, and a simple adminstrative change in the disability requirements could scrap the waiting period even without legislation.[5]

CONCLUSION

The Reagan Adminstration began this catastrophic health care fiasco with great fanfare last year with its proposal for what seemed a modest expansion of Medicare, to be financed by a premium increase of just $4.92 per month. Not only did the Congressional Budget Office find that the Administration underestimated the cost of its proposal, but Congress eagerly began to add new benefits to the plan. It has done so to such a degree that the proposed legislation would involve the largest expansion of Medicare since it was first adopted over 20 years ago. These political and fiscal dynamics were predicted by some at the time but unwisely ignored by Ronald Reagan.[6] Now the Administration is even considering a veto of legislation it first proposed.

Other Steps Needed. Instead of continuing further down the slippery slope of Medicare expansion, responsible lawmakers should consider providing catastrophic coverage in a fundamentally different way from that championed by congressional leaders. Numerous proposals are available to broaden coverage for long-term care

5. Congressional Record E16 (daily ed. January 7, 1987), Statement of Representative Weiss.

6. "Controlling Catastrophic Health Costs: Otis Bowen's Grand Opportunity," Heritage Foundation Backgrounder No. 499, April 3, 1986.

and catastrophic acute care in the private sector.[7] Moreover, steps could be taken to alter the rules governing Medigap insurance and to create insurance and savings plans to meet catastrophic costs.[8]

By contrast, the proposed legislation would impose a massive, discriminatory, income tax increase on elderly Americans, eliminating for them the advantages of last year's tax reform bill--all to finance the wrong benefits under Medicare. Elderly Americans need better protection against catastrophic health care costs. This legislation does not provide it.

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7. Private Sector Task Force on Catastrophic and Long-Term Health Care, Catastrophic and Long-Term Health Care: Private Sector Alternatives (Washington, D.C.: National Chamber Foundation, 1986).

8. "Making Catastrophic Health Care Affordable: A Nine Point Program," Heritage Foundation Backgrounder No. 563, February 10, 1987.