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Obamacare: Impact on the Economy

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The Patient Protection and Affordable Care Act (PPACA), the health care bill signed into law by President Obama in March, will overhaul the current health insurance system by enforcing mandates on individuals and businesses, expanding Medicaid, and introducing new taxes and fines to help pay for the increased "federal budgetary commitment to health care."

Contrary to a key intention of the legislation, the combination of mandates and taxes will not help to reduce the deficit. In fact, the PPACA will likely increase the deficit by an average $75 billion per year, and as a result, the nation's publicly held debt will be $753 billion higher at the end of 2020. Such astronomical debt crowds out other productive investments and will lead to an estimated 670,000 lost job opportunities per year.

Dynamic Analysis Confirms Fears. It was the goal of health care reform to be deficit neutral—as scored by the Congressional Budget Office (CBO)—within the first 10 years of enactment. In order to achieve this goal, the new law immediately imposes a combination of new taxes on high-income individuals, medical devices, and pharmaceuticals and Medicare spending cuts. In addition, the PPACA delays subsidy payments to help make insurance affordable for those with lower incomes and Medicaid expansions to cover more of the uninsured.

However, the *static* budget analysis is limited in that it does not account for how the policy combination of spending and taxes alters the macroeconomic performance of the economy and feeds back onto the budget. A *dynamic* simulation shows that the higher initial costs are not an investment that

pays off with a higher return in later years. Indeed, these front-loaded costs slow economic growth with higher inflation and higher interest rates, which overwhelm the benefits the proposal hoped to gain in later years.

The bill's taxes, penalties, and fees on investors and businesses will decrease the amount of investment in the economy. This reduced investment will in turn lead to a decline in productivity, causing the economy to produce $706 billion less worth of goods and services. A smaller economic pie means that workers earn lower wages and salaries. Higher taxes on investment also put upward pressure on interest rates as investors seek to achieve their after-tax desired rate of return.[1]

Lower wages reduce the amount of taxable income that could otherwise have been achieved. This will both increase the deficit and grow the total debt—which in turn puts upward pressure on interest rates and crowds out some savings that could have gone to new productive business investments.

Higher interest rates mean that more American tax dollars will go toward paying the interest on the federal debt rather than paying down the principal. Simulations using dynamic analysis estimate that the government would spend an average $23 bil-

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lion more per year on interest rate payments over the 2010–2020 year window than it would without the PPACA.[1]

Once the government begins paying for health insurance for individuals through subsidies and bringing people into the government insurance programs in the latter half of the decade, this growing debt will balloon. By the end of the 10 years, debt held by the public will be $753 billion higher than it otherwise would have been.

Higher Premiums. In its analysis of the PPACA, the CBO estimates that health insurance premiums for the non-group market will increase significantly, primarily because of a mandate requiring plans to provide a more generous level of coverage than most do now while virtually eliminating the option of catastrophic coverage. In addition, significantly more individuals will face these higher premiums after the creation of the insurance exchanges begins crowding out the employer-sponsored market and after the individual mandate begins prodding the currently uninsured into buying coverage.[2] The result will be an overall increase in the absolute amount of health spending on premiums (that is, private and public).

The premium and medical spending increases put upward pressure on prices. Thus nominal spending (i.e., the actual dollars spent) that the government anticipates in subsides and payments for increased Medicaid enrollees will actually purchase a lower level of medical care. In turn, the government will have to spend more money to provide adequate insurance to individuals or further ration payments to medical providers. This unanticipated increase in spending further widens the deficit that contributes to the federal debt.

The dynamic analysis shows that the new law will result in 670,000 net job losses, many of which would be in the health services industry. These losses represent both cutbacks in jobs and jobs that are simply never created as talented individuals choose to specialize in other industries that are not subject to the government's payment squeezes. At the same time, newly enrolled and subsidized individuals on the government's rolls will cause the demand for health services to increase. In turn, prices will rise even more than anticipated, and greater rationing will occur. Thus, this legislation will fail to meet its primary goal: to enable greater access to health care while "bending the cost curve downward."

Taxing the Job Creators. The PPACA also increases the Medicare hospital insurance component of the payroll tax on wages and self-employment income in excess of $200,000 ($250,000 joint) by 0.9 percentage point—a provision that will raise around $18 billion per year. This "tax on the rich," however, will actually affect small businesses as well as salary earners, because the hospital insurance tax applies to "flow-through income" of those small businesses that file taxes as individuals. In fact, almost $16 billion out the total $18 billion of revenue will come from filers with at least some flow-through income. Small businesses at all earning levels that file individually—even those already facing losses—will see a tax increase.

In a time when firms are making hard decisions about layoffs, successful businesses could face tax increases of thousands of dollars. The overall average tax increase faced by small businesses filing individually would be about $600.

Repeal Is Needed. Mandates add rigidities to the economy, which in turn reduce the ability of the economy to make the needed adjustments to ever-changing economic conditions. These inflexibilities reduce economic growth by stifling the new innovations that a dynamic population demands, resulting in slower economic growth, longer periods of unemployment, and reduced opportunities for savings and investment used to build nest eggs for households.

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1. For a discussion of the how investment taxes affect the economy, see Karen A. Campbell and Guinevere Nell, "The President's Health Proposal: Taxing Investments Undermines Economic Recovery," Heritage Foundation *WebMemo* No. 2817, February 25, 2010, at *http://www.heritage.org/Research/Reports/2010/02/The-Presidents-Health-Proposal-Taxing-Investments-Undermines-Economic-Recovery*.

2. See Rea S. Hederman, Jr., and Paul L. Winfree, "How Health Care Reform Will Affect Young Adults," Heritage Foundation *Center for Data Analysis Report* No. 10-02, January 27, 2010, at *http://s3.amazonaws.com/thf_media/2010/pdf/CDA_10-02.pdf*.

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A combination of mandates and taxes will not reduce health care costs or ensure that all citizens have good access to health care. Instead, mandates will burden already struggling businesses with new costs and punish individuals for not having high-paying jobs. New taxes will burden small businesses as well as large ones and force many firms to make layoffs, further hurting workers. The best way to prevent further erosion of the economy is to repeal the new law.

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APPENDIX

Microeconomic Simulation. Personal income tax provisions of the PPACA were simulated using the Center for Data Analysis Individual Income Tax Model in order to estimate effects on revenue and distribution of tax burden. The model simulates the effect of tax law changes on a representative sample of taxpayers. Data for these taxpayers are extrapolated (or "aged") to reflect detailed taxpayer characteristics through 2016. The data are aged for consistency with the CBO baseline forecast from the Global Insight model in order to produce effective and marginal tax rate estimates with which to forecast dynamic effects of the changes in tax burden.

Two simulations were run for comparison: (1) current law prior to the PPACA, and (2) current law with the addition of the individual income tax provisions of the PPACA. The provisions affecting individual income that were simulated were the increase in the Medicare hospital insurance component of the payroll tax on wages and self-employment income and the increase in the adjusted gross income floor of the medical expenses deduction from 7.5 to 10 percent. These were run together in a single simulation and compared with the simulation of current law in order to determine revenue, effective tax rate, and distributional effects.

For the purpose of presenting tax policy effects on small businesses, a small business is defined as a business that reported income using a Schedule C or reported income as a partnership or S-corporation.

Macroeconomic Simulation. Heritage analysts used the IHS/Global Insight February 2010 short-term model of the U.S. economy to estimate the overall net economic effects of the PPACA.[3] The baseline represents the most likely path of the U.S. economy in the next 10 years. The relationships in the model are calibrated by historical U.S. data and mainstream economic theory.

The model is a tool that gives insight into the likely magnitude and direction of the policy changes in a dynamic world where many indirect effects can play out. This gives policymakers the information they need to determine which policies will lead to a stronger, more robust economy and which policies will weaken the economy and lead to fewer opportunities for citizens in the future.

The simulation was conducted by estimating the direct price changes that would likely occur in the health care markets. The price changes were calculated using estimates of the aggregate changes in premiums and coverage by the CBO as well as data on insurance coverage type from the 2009 March Supplement of the Current Population Survey and the 2007 Household Component of the Medical Expenditure Panel Survey.[4] The percentage change in prices was factored into the health care price index variable and the benefits portion of employment cost index. (The former was a price increase, the latter a slight decrease.)

The excise tax on high-premium plans affects prices in the health care markets and was therefore accounted for in the price index changes.

The hospital insurance taxes on high income and investment income affect individual average tax rates. The CBO estimated revenue from these taxes. These estimates were used to calculate the implied change in average effective tax rates. The implied changes were factored into the average effective personal tax rate variable. The tax changes were also simulated in the tax microsimulation model. The rates estimated from the microsimulation were used

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3. The IHS/Global Insight model is used by private-sector and government economists to estimate how changes in the economy and public policy are likely to affect major economic indicators. The methodologies, assumptions, conclusions, and opinions presented here are entirely the work of analysts at The Heritage Foundation's Center for Data Analysis. They have not been endorsed by, and do not necessarily reflect the views of, the owners of the IHS/Global Insight model.

4. Douglas W. Elmendorf, letter to the Honorable Nancy Pelosi (D–CA), March 20, 2010, at *http://www.cbo.gov/ftpdocs/113xx/doc11379/Manager'sAmendmenttoReconciliationProposal.pdf* (May 28, 2010); Congressional Budget Office, "An Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act," November 30, 2009, at *http://www.cbo.gov/ftpdocs/107xx/doc10781/11-30-Premiums.pdf* (March 15, 2010).

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to check the macrosimulation of the overall effective rate. Both the dynamic macro- and static microsimulation estimated similar changes to average effective rates (in the range of 0.1 percentage point).

Penalties and fees on businesses and taxes on medical devices and pharmaceutical drugs were assumed to affect corporate taxes. The CBO's esti-mated revenues were used to calculate an implied change in the corporate tax rate.

The net changes in Medicaid spending per year, estimated by the CBO, were used as a proxy for real federal grants to state and local governments for Medicaid in the model.