

# WebMemo



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## Mandates and Taxes Re-Burden Health Insurance Markets

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The Patient Protection and Affordable Care Act (H.R. 3590), the health care reform bill that was passed by the Senate and is now being considered by the House, promises to 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, H.R. 3590 will likely increase the deficit by an average \$76 billion per year, and as a result, the nation’s publicly held debt will be \$755 billion higher at the end of 2020. Such astronomical debt crowds out other productive investments and will lead to an estimated 690,000 lost job opportunities per year.

Policies designed to achieve a one-dimensional goal—getting more people insured at any cost—jeopardizes other worthy goals such as job creation, economic growth, fiscal sustainability, and greater opportunity. Furthermore, economic analysis of H.R. 3590 shows that using mandates and higher taxes to force otherwise involuntary universal health insurance actually makes achieving the goal of affordable health care even harder.

**Dynamic Analysis Confirm Fears of Front-Loaded Economic Damage.** The Senate bill’s goal is to be deficit neutral—as scored by the Congressional Budget Office (CBO)—within 10 years. In order to achieve this goal, the bill immediately imposes a combination of new taxes on high-income individuals and on medical devices and

pharmaceuticals and Medicare spending cuts. In addition, the bill 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. (See Chart 1.)

The bill’s taxes, penalties, and fees on investors and businesses would decrease the amount of investment in the economy. This reduced investment would in turn lead to a decline in productivity, causing the economy to produce \$752 billion less worth of goods and services. A smaller economic pie would mean 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.<sup>1</sup>

This paper, in its entirety, can be found at:  
<http://report.heritage.org/wm2834>

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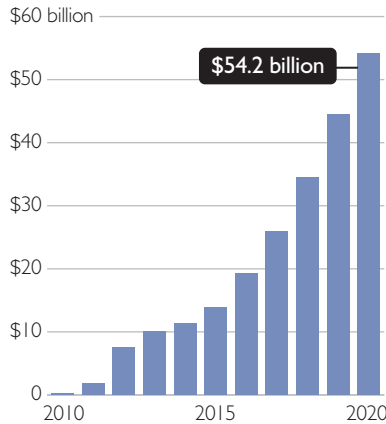
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## By 2020, the Senate Health Care Bill Would ...

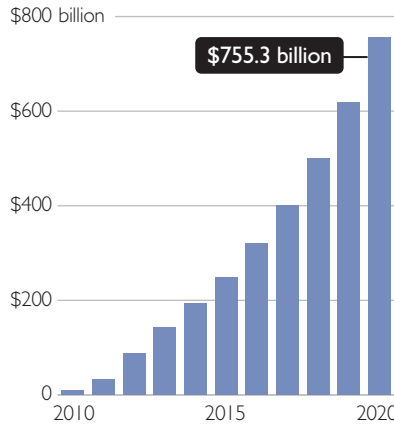
**1** ... increase federal interest payments by an average of \$20.3 billion per year.

Change in Federal Net Interest Payments



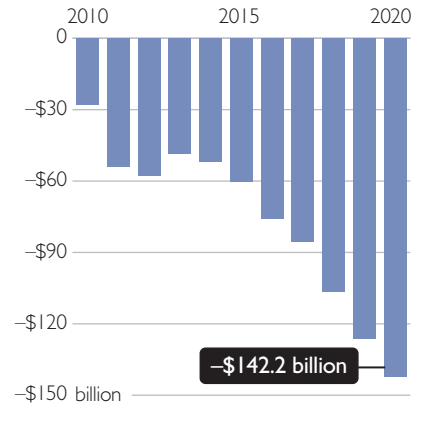
**2** ... raise the national debt by more than \$755 billion.

Change in Total Debt Held by the Public



**3** ... increase annual federal budget deficits by an average of \$76 billion.

Change in Federal Budget Surplus/Deficit



Source: Heritage Foundation calculations based on the IHS/Global Insight U.S. Macroeconomic model.

Note: Figures are based on the unified budget.

Chart 1 • WM 2834 [heritage.org](http://heritage.org)

Lower wages reduce the amount of taxable income that otherwise could have been achieved. This would 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 of American tax dollars would 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 \$20 billion more per year on interest rate payments over the 2010–2020 year window.

Once the government begins paying for health insurance for individuals through subsidies and bringing people into the government insurance pro-

grams in the latter half of the decade, this growing debt would balloon. By the end of the 10 years, debt held by the public would be \$755 billion higher than it otherwise would be.

**Higher Premiums.** In its analysis of the Senate bill, the CBO estimates that health insurance premiums for the non-group market would 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 would 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.<sup>2</sup> The result would be an overall

1. For a discussion of the how investment taxes affect the economy see Karen 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>.

increase in the absolute amount of health spending on premiums (that is, private and public).

The premium and medical spending increases that CBO estimates puts upward pressure on prices. Thus nominal spending (i.e., the actual dollars spent) that the government anticipates in subsidies and payments for increased Medicaid enrollees would actually purchase a lower level of medical care. In turn, the government would 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 this bill would result in 690,000 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 would cause the demand for health services to increase. In turn, prices would rise even more than anticipated, and greater rationing of demand would occur. Thus, this legislation would fail to meet its primary goal: to enable greater access while "bending the cost curve downward."

**Taxing the Job Creators.** The Senate bill 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 points—a provision that would raise around \$18 billion per year. This "tax on the rich," however, would 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 would come from filers with at least some flow-through income. Small businesses filing individually with earnings at all lev-

els—even those already facing losses—would see a tax increase.

In a time when firms are making hard decisions about layoffs, businesses facing losses of more than \$5,000 would potentially face a tax increase of \$500. Successful businesses could face tax increases of thousands of dollars. The overall average tax increases faced by small businesses filing individually would be about \$600.

**Re-Forming Legislation Is Needed.** Americans are looking to the government to reform outdated insurance rules so that buyers and sellers in the insurance market can meet their needs for cost-effective insurance.

Most Americans are not, however, looking for the government to expand its "business model" and take over their health insurance. As recently experienced with Fannie Mae and Freddie Mac, such a takeover reduces the government's effectiveness by creating conflicts of interest for itself when making and enforcing rules for the private sector.

Mandates add rigidities to the economy, which in turn reduces 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.

A combination of mandates and taxes does not reduce health care costs or ensure that all citizens have good access to health care. Instead, mandates burden already struggling businesses with new costs and punish individuals for not having high-paying jobs. New taxes would burden small businesses as well as large ones and force many firms to make layoffs, further hurting workers.

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2. Rea Hederman, Jr., and Paul 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](http://s3.amazonaws.com/thf_media/2010/pdf/CDA_10-02.pdf).

## APPENDIX

**Microeconomic Simulation.** Personal income tax provisions of the Patient Protection and Affordable Care Act 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.

U.S. Census poverty threshold projections were used to estimate the effect on filers under 400 percent of the poverty line. A small business is defined as a business that reported income using a Schedule C, or that 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 Patient Protection and Affordable Care Act.<sup>3</sup> 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 affects 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 calcu-

lated 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.<sup>4</sup> The percentage change in prices was used to add factor 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 therefore was 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. The CBO estimates were used to calculate the implied change in average effective tax rates. The implied changes were factored to the average effective personal tax rate variable. The tax changes were also simulated in the tax microsimulation model (see the microsimulation appendix). The rates estimated from the microsimulation were used 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 estimated revenues were used to calculate an implied change in the corporate tax rate.

The net changes in Medicare and Medicaid spending per year, estimated by the CBO, were used to change the “Real Federal Medicaid Grants to State and Local Governments” variable.

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. See Congressional Budget Office, “H.R. 3590, Patient Protection and Affordable Care Act,” March 11, 2010, at [http://www.cbo.gov/ftpdocs/113xx/doc11307/Reid\\_Letter\\_HR3590.pdf](http://www.cbo.gov/ftpdocs/113xx/doc11307/Reid_Letter_HR3590.pdf) (March 15, 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).