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Obama's Prescription for Low-Wage Workers
High Implicit Taxes, Higher Premiums

by Michael F. Cannon

Executive Summary

House and Senate Democrats have produced health care legislation whose mandates, subsidies, tax penalties, and health insurance regulations would penalize work and reward Americans who refuse to purchase health insurance. As a result, the legislation could trap many Americans in low-wage jobs and cause even higher health-insurance premiums, government spending, and taxes than are envisioned in the legislation.

Those mandates and subsidies would impose effective marginal tax rates on low-wage workers that would average between 53 and 74 percent—and even reach as high as 82 percent—over broad ranges of earned income. By comparison, the wealthiest Americans would face tax rates no higher than 47.9 percent.

Over smaller ranges of earned income, the legislation would impose effective marginal tax rates that exceed 100 percent. Families of four would see effective marginal tax rates as high as 174 percent under the Senate bill and 159 percent under the House bill. Under the Senate bill, adults starting at $14,560 who earn an additional $560 would see their total income fall by $200 due to higher taxes and reduced subsidies. Under the House bill, families of four starting at $43,670 who earn an additional $1,100 would see their total income fall by $870.

In addition, middle-income workers could save as much as $8,000 per year by dropping coverage and purchasing health insurance only when sick. Indeed, the legislation effectively removes any penalty on such behavior by forcing insurers to sell health insurance to the uninsured at standard premiums when they fall ill. The legislation would thus encourage "adverse selection"—an unstable situation that would drive insurance premiums, government spending, and taxes even higher.

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Introduction

House and Senate Democrats have produced health care legislation whose mandates, subsidies, tax penalties, and health insurance regulations would penalize work and reward Americans who refuse to purchase health insurance. As a result, the legislation could trap many Americans in low-wage jobs and cause even higher health-insurance premiums, higher government spending, and higher taxes than are envisioned in the legislation.

The legislation would penalize work by reducing the share of each additional dollar of income that workers would keep. Under either bill, low- and middle-income earners who work extra hours, accept a promotion, take a second job, or invest in education and training would see little benefit. Some could even end up worse off financially. Over time, those workers would see their taxes rise even if their incomes remain stagnant.

Two features of the legislation would create those high implicit tax rates. First, each bill contains an "individual mandate" that would require all Americans to purchase health insurance and would force low- and middle-income Americans to pay an increasing share of their incomes toward their premiums as their income rises. Second, the bills would create health-insurance subsidies that phase out as a worker's income rises. As the individual mandate imposes new, rising marginal tax rates on low- and middle-income workers, the phased-out subsidies would create even higher effective marginal tax rates.

Economists use the term "effective marginal tax rates" to describe the combined effect that taxes and phased-out government subsidies have on a worker's incentive to earn an additional dollar. High effective marginal tax rates have the same effect on work incentives as high statutory rates: both discourage workers from climbing the economic ladder. The Congressional Budget Office writes:

> To limit costs, subsidies are typically phased out as a beneficiary's income rises. Over the phase-out range, a worker receives less compensation for each additional hour worked, because each dollar earned reduces the subsidy.[1]
>
> Proposals that decreased the economic gains from an additional hour of work, through higher taxes or the phase-out of subsidies or credits for health insurance as income rises, could cause some people to work less or not at all.[2]
>
> That effect, known as an "implicit tax," can lead people to work fewer hours than they otherwise would, in the same way that income and payroll tax rates do. Most empirical studies conclude that increases in marginal tax rates generally reduce the number of hours worked, particularly among secondary earners (typically, the spouse of the main earner in a family). Higher tax rates also reduce people's incentive to raise their income in other ways, such as working harder in the hope of winning raises; accepting new positions or responsibilities with higher compensation; or investing in their future earning capacity through education, training, or other means.[3]

For example, "one study found that a series of increases in the income limit for Medicaid eligibility in the late 1980s and 1990s increased the labor force participation of working-age single mothers by 1.4 percent."[4] That suggests the prospect of losing subsidies discouraged able-bodied individuals from working. Harvard economist Gregory Mankiw writes, "substantial evidence supports the . . . proposition that high marginal tax rates discourage people from working to their full potential."[5]

In addition, though the legislation's purpose is to expand health insurance coverage, it would create large financial incentives for middle-class Americans not to purchase health insurance. Although the bill contains subsidies to purchase insurance and penalties for Americans that do not, households that choose to go uninsured could still come

out thousands of dollars ahead. Since the legislation would force insurers to sell health insurance to everyone at standard rates, healthy people could decline coverage, save their money, and purchase health insurance only when sick. The legislation could thus lead to an "adverse selection death spiral"—an unstable situation that would drive insurance premiums, government spending, and taxes even higher.

Methods

This paper calculates the federal marginal tax rates and effective marginal tax rates that single, childless adults and families of four would face under the health care legislation approved by the U.S. House of Representatives and the U.S. Senate. It also calculates the penalties that those low- and middle-income workers would face if they chose not to purchase coverage.

Information on mandate requirements, penalties, health-insurance subsidies, and cost-sharing subsidies comes from the legislation.[6] Estimates of the likely cost of coverage in the health insurance exchanges (upon which the subsidies depend) come from CBO estimates of the likely cost of health insurance under each bill.[7] Data on the income tax,[8] payroll tax,[9] child tax credit,[10] and earned-income tax credit[11] come from the Internal Revenue Service.

These estimates show what full implementation of the mandates, subsidies, and penalties would look like in 2009. Unless noted, all dollar figures use 2009 dollars. The CBO's estimates of health insurance premiums are deflated to 2009 dollars using the average growth rate of health insurance premiums from 2004 through 2009 (6.1 percent).[12] Other dollar figures are deflated to 2009 dollars using the projected rate of inflation from 2010 through 2016 found in the CBO's Economic Projections for Calendar Years 2009 to 2019.[13] Consistent with the legislation, these estimates use federal poverty thresholds for 2008.[14]

The calculations underlying these estimates are available on request.

A Low-Wage Trap

Both the House and Senate bills would impose an "individual mandate" that would make health insurance compulsory for nearly all Americans. Under an individual mandate, the federal government would use its sovereign power to compel people to purchase health insurance, whether they want it or not, under threat of fines and/or imprisonment.[15] As a result, mandatory premium payments amount to a tax even though the money never enters the federal treasury (see box).

Each bill would also create a new health insurance "exchange" (or multiple exchanges), where certain U.S. residents could purchase health insurance. According to the nonpartisan CBO, some 23 million Americans would initially obtain health insurance through the Senate bill's exchanges.[16] Under both bills, the number of Americans who obtain insurance through the exchange(s) would likely grow over time.[17]

The bills would require low- and middle-income workers to pay a specified percentage of their adjusted gross income (AGI) toward mandatory health insurance. That specified percentage would rise as a worker's adjusted gross income rises. The "mandate tax" would therefore consume an increasing share of each additional dollar of earnings for low- and middle-class workers, effectively increasing the marginal tax rates that the federal government imposes on those workers.

Also within the exchanges, the legislation would create subsidies for low- and middle-income earners—specifically, refundable health-insurance tax credits and cost-sharing tax credits—that would decrease and ultimately disappear as household earnings rise.

The Mandate Tax

Each bill would force low- and middle-income workers to pay a specified percentage of their income toward the cost of health

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Is the Individual Mandate a Tax?

President Obama argues that a legal requirement for individuals to purchase health insurance is not a tax.[18] Yet many economists, including some of President Obama's economic advisers, consider it to be a type of tax.

Princeton University health economist Uwe Reinhardt writes, "[Just because] the fiscal flows triggered by [the] mandate would not flow directly through the public budgets does not detract from the measure's status of a *bona fide tax*."[19]

MIT health economist Jonathan Gruber writes, "Suppose . . . the government mandated that everyone buy full insurance at the average price. . . . This would not be a very attractive plan to careful consumers . . . who could view themselves as essentially being taxed in order to support this market, by paying higher premiums than they should based on their risk."[20]

President Obama's National Economic Council chairman Larry Summers writes, "Essentially, mandated benefits are like public programs financed by benefit taxes."[21]

Sherry Glied, President Obama's appointee to assistant secretary for planning and evaluation at the Department of Health and Human Services, writes, "The individual mandate . . . is in many respects analogous to a tax. It requires people to make payments for something whether they want it or not."[22]

When the Clinton administration proposed an individual mandate in 1993, the CBO went so far as to treat the mandatory premiums that Americans would pay as federal revenues and include them in the federal budget.[23] So far, the CBO has not done the same for the mandates in the House and Senate bills. (As Reinhardt suggests, that does not imply that those mandates are not a tax.)

Each bill would also impose penalties on individuals (and employers) who do not comply with the health-insurance mandates. Those penalties would be paid to the Internal Revenue Service along with one's income taxes.[24]

The House and Senate bills violate the universally accepted principle that marginal tax rates should only apply to income at the margin.

insurance. The product of that "mandate-tax rate" and the worker's adjusted gross income determines each worker's mandate-tax liability.[25] For low- and middle-income workers, the mandate-tax rate rises as their earnings rises. It also rises with the average growth rate of health insurance premiums, independent of a worker's income.

As shown in Tables 1 and 2, the House bill would require those at 133 percent of the federal poverty level (FPL)—about $15,000 for a single, childless adult and $29,000 for a family of four—to pay 1.5 percent of their adjusted gross income toward their health insurance premiums. That mandate-tax rate would rise gradually with income until it reached 12 percent for those at 400 percent FPL (about $45,000 for singles, and $87,000 for families of four).

Likewise, the Senate bill would require workers at 100 percent FPL (about $11,000 for singles and $22,000 for families of four) to pay 2 percent of adjusted gross income toward the cost of their coverage. The mandate-tax rate would then rise with income until it reached 9.8 percent for workers at 300 percent FPL. It would then remain at 9.8 percent until adjusted gross income reaches 400 percent FPL. Above 400 percent FPL, workers would be responsible for 100 percent of their premiums.

The actual marginal tax rates that result, however, would exceed those statutory mandate-tax rates. Each bill would apply its rising mandate-tax rates not just to income above a certain threshold, but to every single dollar of adjusted gross income. That is, the bills would apply rising marginal tax rates not just

Table 1
Explicit and Implicit Tax Rates for Single, Childless Adults

	Federal Poverty Level Range	Income Range (2009)*	Statutory Mandate-Tax Rates	Marginal Mandate-Tax Rates (5% FPL increments)	Effective Marginal Tax Rate (Average)	Effective Marginal Tax Rates (5% FPL increments)	Max. Annual Savings from Dropping Coverage (2009)**
House bill (H.R. 3962)	133%–400%	$15,000–$45,000	1.5%–12%	10%–20%	59%	28%–110%	$2,600
Senate (H.R. 3590)	100%–400%	$11,000–$45,000	2%–9.8%	2%–53%	53%	25%–125%	$2,900

*Dollar figures rounded to the nearest thousand.
**Dollar figures rounded to the nearest hundred.

Table 2
Explicit and Implicit Tax Rates for Families of Four

	Federal Poverty Level Range	Income Range (2009)*	Statutory Mandate-Tax Rates	Marginal Mandate-Tax Rates (5% FPL increments)	Effective Marginal Tax Rate (Average)	Effective Marginal Tax Rates (5% FPL increments)	Max. Annual Savings from Dropping Coverage (2009)**
House bill (H.R. 3962)	133%–400%	$29,000–$87,000	1.5%–12%	10%–20%	74%	37%–159%	$7,800
Senate (H.R. 3590)	100%–400%	$22,000–$87,000	2%–9.8%	2%–53%	62%	37%–174%	$8,000

*Dollar figures rounded to the nearest thousand.
**Dollar figures rounded to the nearest hundred.

to the marginal dollar, but to every *infra*-marginal dollar as well. The House and Senate bills thus violate the universally accepted principle of taxation that marginal tax rates should only apply to income at the margin.

To illustrate, under current law, the federal income tax rate rises from 10 percent to 15 percent once a single filer's taxable income exceeds $8,350.[26] If taxable income is $8,400, then the first $8,350 is taxed at the 10-percent rate (tax: $835), and the marginal $50 is taxed at the 15-percent rate (tax: $7.50), for a total tax liability of $842.50. If the income tax were to operate like the Democrats' mandate tax, then earning $50 above the threshold would subject all $8,400—not just the marginal $50—to the 15-percent rate. That marginal $50 would therefore cause the worker's tax liability to jump not by $7.50, but by $425.[27] The actual marginal tax rate applied to that $50 would not be 15 percent, but 850 percent. In the same manner, the House and Senate bills would create marginal tax rates that exceed the statutory mandate-tax rates.

Each bill would therefore impose a new mandate tax, with hidden rising marginal tax rates, on low- and middle-income workers. Table 1 shows the range of marginal tax rates that the bills would impose on low- and middle-income single adults. Table 2 shows the

Workers could see their tax rates rise even if their real incomes were to remain stagnant or fall.

same data for families of four. The House bill would create new marginal tax rates that would reach as high as 20 percent for both singles and families of four. The Senate bill would impose marginal tax rates as high as 53 percent for both singles and families of four.[28]

Tables 1 and 2 show the marginal tax rates that the bills would create in their first year of implementation. Under both bills, those marginal tax rates would rise automatically over time. After the first full year of implementation, the mandate-tax rates would grow at the same rate as health insurance premiums, independent of workers' incomes.[29] Since health insurance premiums tend to grow faster than wages or inflation, middle-class workers could see their tax rates rise even if their real incomes were to remain stagnant or fall.

Phased-Out Subsidies

Within the exchanges, the bills would also create means-tested subsidies whose withdrawal, when combined with the mandate tax, would impose even higher effective marginal tax rates. The bills would create two types of subsidy that would contribute to this effect.

The first is a subsidy called a "premium tax credit." The amount that low- and middle-income workers would have to pay toward their health insurance premiums would generally be less than the full premium. To make up the difference, each bill would create premium tax credits. The amount of these credits would be the difference between a specified "reference premium" and the worker's mandate-tax liability:

Health-Insurance Tax Credit = (Reference Premium) – (Mandate-Tax Liability)

The tax credits therefore phase out as income rises; that is, as one's mandate-tax liability approaches the reference premium.[30]

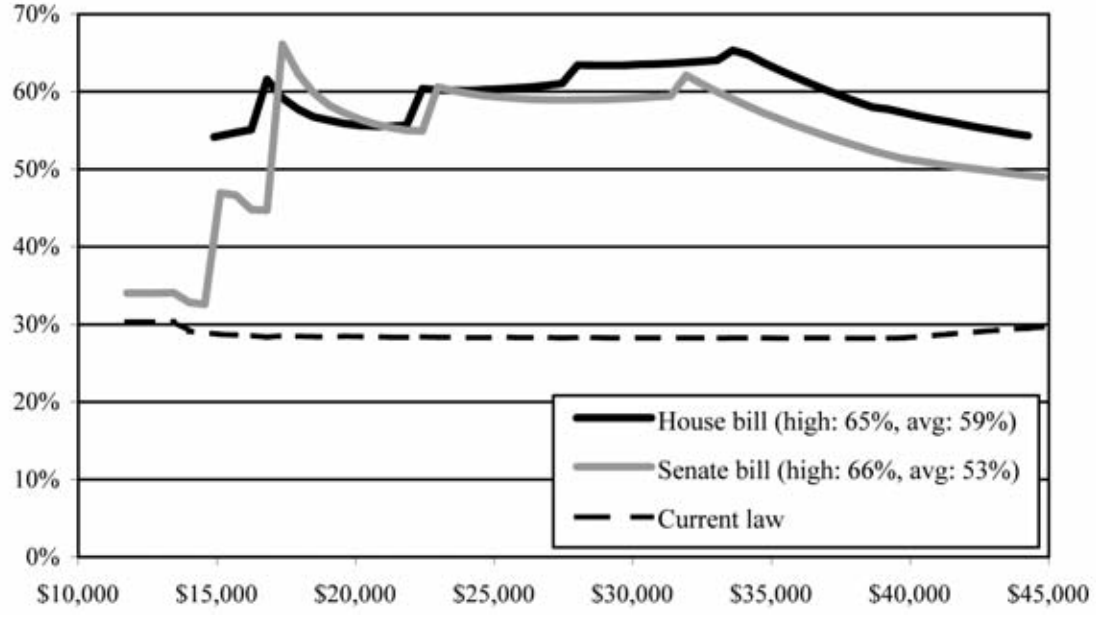
The bills would also create subsidies called "cost-sharing tax credits." These subsidies would increase the comprehensiveness of an eligible household's health plan to a specified actuarial value. Those actuarial values are higher for low-income households and fall if a household's earnings rise. (Calculating the value of the cost-sharing subsidies is thus similar to calculating the value of the health-insurance tax credits.) The value of these subsidies falls abruptly when a worker's adjusted gross income passes certain thresholds. That creates a "cliff" effect, where a small increase in earnings leads to a large decrease in total income.

A Steep Climb out of Poverty

The following estimates incorporate the effects of federal payroll taxes, income taxes, the child tax credit, and the earned-income tax credit to reveal the effective marginal tax rates that the House and Senate health care bills would impose on low- and middle-income workers enrolled in the health insurance exchange(s). Effective marginal tax rates would vary depending on a household's starting income and the amount of additional income earned (i.e., the size of the margin). Thus, Figures 1 through 4 offer different ways of portraying how the bills would affect work incentives.

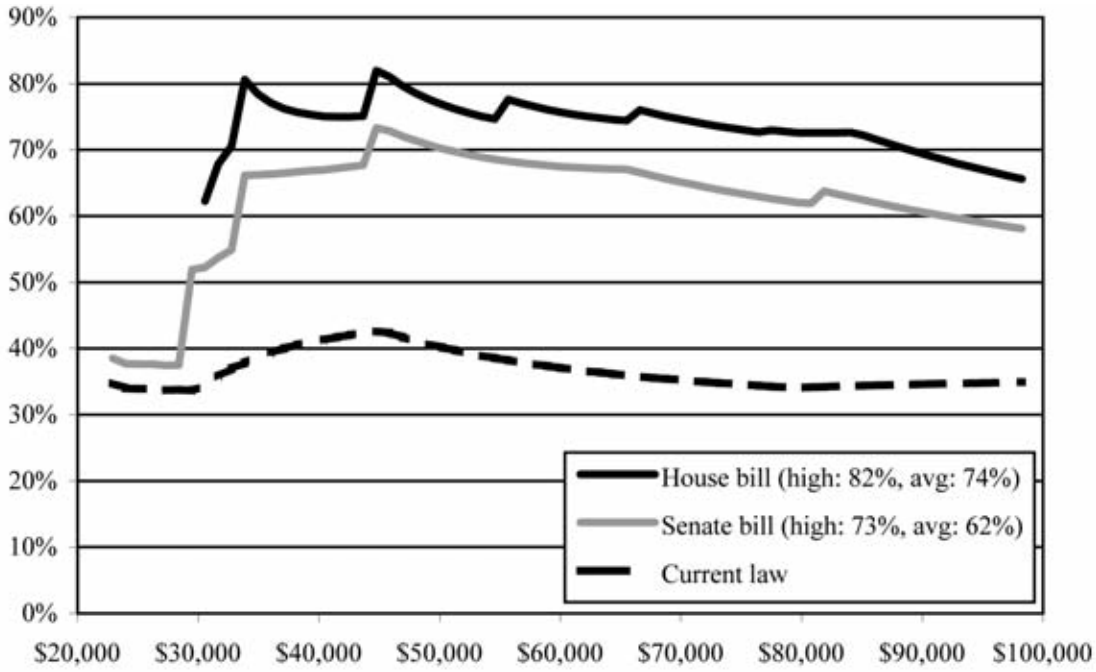
Figures 1 and 2 show the *overall* or *average* effective marginal tax rates that low-wage workers would face over a broad range of earnings. Figure 1 shows that under the House bill, single adults starting at $15,000 per year would face an average effective marginal tax rate of about 59 percent as they work toward increasing their earnings to $45,000. That is, they would keep about 41 cents out of each additional dollar earned along the way, and would lose the remainder to higher taxes and forgone subsidies. If they increased their earnings to $34,000, however, their average effective marginal tax rate would be 65 percent—that is, their total income would only rise by about $1 for every additional $3 earned. Under the Senate bill, single adults starting at $11,000 would face an average effective marginal tax rate of 53 percent. Until they pass $45,000 of earnings, their total income would have risen just 47 cents for each additional dollar of earned income. Their average effective marginal tax rate could also rise as high as 66 percent. (See Figure 1.)

Figure 1
Overall or Average Effective Marginal Tax Rates for Single, Childless Adults Who Start at $12,000 (100% FPL) under the Senate Bill or $15,000 (133% FPL) under the House Bill



Adjusted Gross Income (2009 dollars)

Figure 2
Overall or Average Effective Marginal Tax Rates for Families of Four Who Start at $23,000 (100% FPL) under the Senate bill or $31,000 (133% FPL) under the House bill



Adjusted Gross Income (2009 dollars)

Single adults who earn an additional $560 could face effective marginal tax rates as high as 110 percent under the House bill and 125 percent under the Senate bill.

Effective marginal tax rates would be even higher for families of four. The House bill would impose an average effective marginal tax rate of 74 percent on families of four starting at $29,000 per year. On average, their total income would have risen just 26 cents for each additional dollar of earned income, until earned income reached about $90,000 per year. Again, their average effective marginal tax rate would often be higher. A family of four that struggled to climb from $30,000 to $45,000 would get to keep less than $3,000 of that additional $15,000 earned; their implicit tax rate would exceed 80 percent. Under the Senate bill, families of four starting at $22,000 would face average effective marginal tax rates of 62 percent, letting them keep just 38 cents of each additional dollar of earnings. If they increased their earnings to about $45,000, their average effective marginal tax rate would be 73 percent. (See Figure 2.)

People often face opportunities to increase their earnings by smaller amounts. Figures 3 and 4 therefore depict the effective marginal tax rates that would apply to smaller changes in earned income.

Figure 3 presents effective marginal tax rates for single adults at any given earnings level who increase their earnings by an amount equal to 5 percent of the federal poverty level, or roughly $560. Single adults who earn an additional $560—say, by working extra hours—could face effective marginal tax rates as high as 110 percent under the House bill and 125 percent under the Senate bill. For example, under the Senate bill, adults with an annual income of $14,560 who earn an additional $560 would see their total income fall by $200. They would thus be financially better off not having worked the extra hours. Under the House bill, adults with $22,400 of income who earn another $560 would see their total income fall by $143. At present, single adults in this earnings range face effective marginal tax rates no higher than 38 percent.

Similarly, Figure 4 shows the effective marginal tax rates for families of four, at any given earnings level, who increase their earnings by 5

Figure 3
Effective Marginal Tax Rates for Single, Childless Adults at Any Initial Earned Income, Who Increase Earnings by $560 (5% FPL)

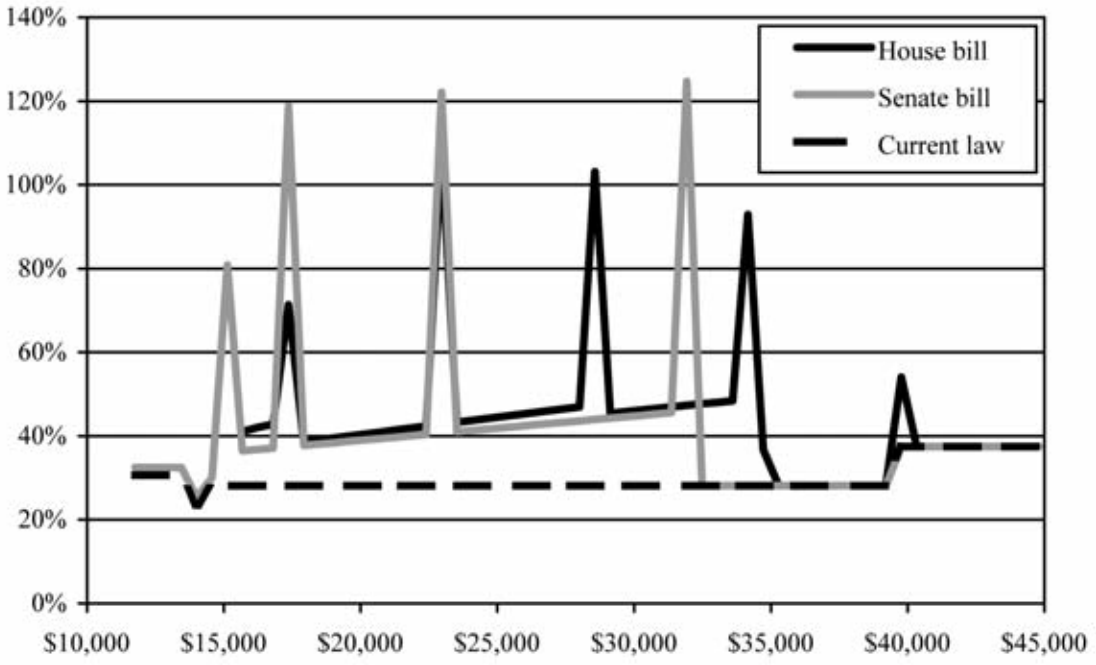
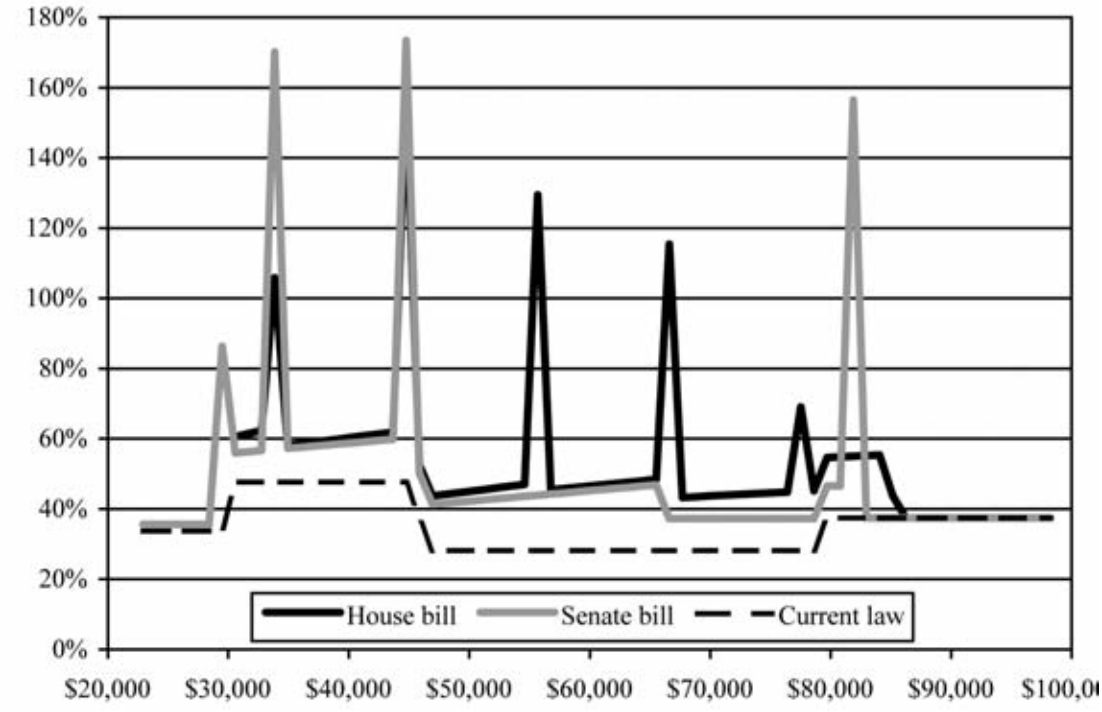


Figure 4
Effective Marginal Tax Rates for Families of Four at Any Initial Earned Income, Who Increase Earnings by $1,100 (5% FPL)



percent of the federal poverty level (roughly $1,100). Families of four would see effective marginal tax rates as high as 159 percent under the House bill and 174 percent under the Senate bill. Under the Senate bill, families of four starting at $28,380 who earn another $1,100 would see their total income fall by $450. Under the House bill, families of four starting at $43,670 who earn an additional $1,100 would see their total income fall by $870, leaving them worse off financially.

Under current federal tax law, effective marginal tax rates do not reach even 50 percent for families of four in this income range. Even the wealthiest Americans would not face effective marginal tax rates as high as those that the Democrats' health care bills would impose on low- and middle-income earners. Under the House bill, the wealthiest Americans would face a marginal tax rate of just 47.9 percent.[31]

Caveats

These estimates do not include the effects that state income taxes and other means-tested government subsidies would have on targeted workers. Insofar as such policies exist, these estimates understate the effective marginal tax rates that low- and middle-income workers would face under the House and Senate legislation. For example, within the range of income examined here, many states impose marginal income-tax rates of 5 percent or more. Californians with incomes in this range could pay a marginal state income-tax rate of 6.25 percent or even 8.25 percent.

The Senate bill contains provisions intended to dampen those work disincentives.[32] The IRS would determine a worker's mandate-tax rate based on what she reports her household income will be in the coming year. If household income is higher than expected, the IRS would require her to pay more toward her

Families of four would see effective marginal tax rates as high as 159 percent under the House bill and 174 percent under the Senate bill.

Under the Senate bill, singles could save up to $2,900 per year, while families of four could save $8,000 per year by dropping coverage.

health insurance premiums—but still not as much as she would have been expected to pay had the income prediction been accurate. Such provisions can temporarily mitigate, but they cannot eliminate, the work disincentives created by the mandate tax and the phased-out subsidies. To the extent that they do mitigate those work disincentives, those provisions add to the cost of the legislation. The CBO explains:

> Policymakers face a trade-off in deciding how to phase out subsidies. If subsidies are large and are phased out quickly, the implicit tax rates, and thus the negative impact on work incentives, can be quite high. Implicit tax rates can be reduced by expanding the range over which the subsidy is phased out, but doing so increases the number of people subject to the implicit tax and boosts the total cost of the subsidy. In the extreme, the same subsidy can be granted to everyone, but doing so substantially increases budgetary costs, which might in turn be financed through higher explicit tax rates.[33]

The high effective marginal tax rates that the House and Senate legislation would create cannot be fixed with a quick amendment. They are an inherent part of the bills' strategy of expanding coverage by shifting costs to taxpayers, rather than by reducing costs through greater efficiency.[34] The only way to expand coverage while avoiding both those perverse incentives and the alternative exorbitant costs is to abandon the bills' strategy of robbing Peter to pay Paul, and instead reduce the cost of care through innovation and competition.[35]

Incentives to Drop Coverage

The bills likewise would create perverse incentives for exchange-eligible workers not to purchase health insurance at all. Each bill would impose both a "guaranteed issue" requirement and "community rating" price controls on insurers.[36] Guaranteed issue requires insurers to issue policies to all applicants, while community rating prohibits insurers from setting premiums according to an applicant's health status. In combination, guaranteed issue and community rating enable consumers to avoid health insurance until they are sick, and then buy coverage from any insurer at standard premiums.

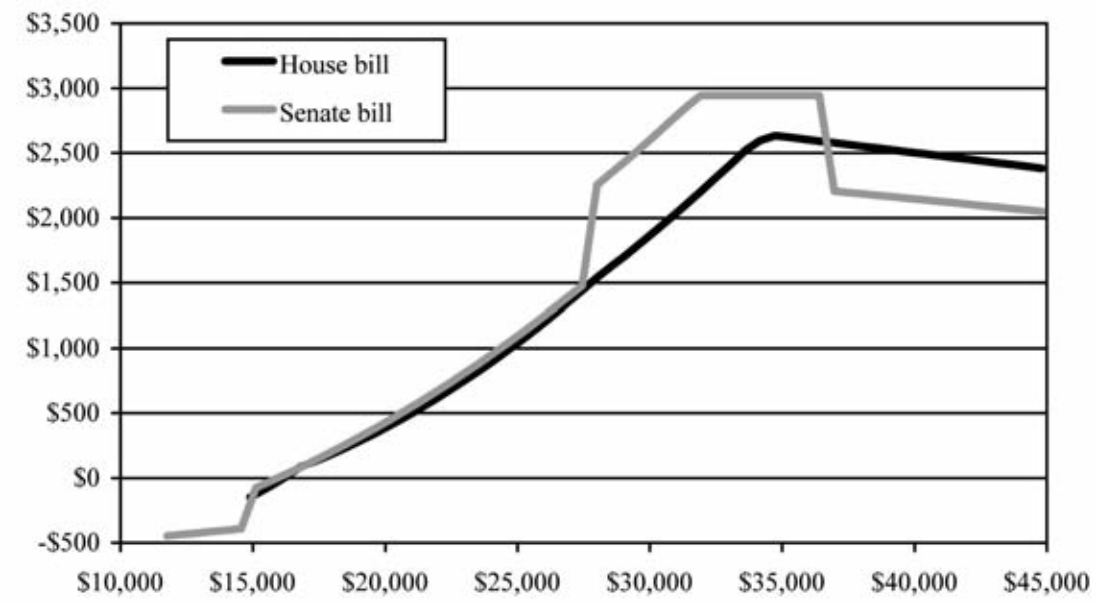
Penalties for Noncompliance

To mitigate such behavior, the legislation would impose explicit tax penalties on Americans who do not purchase health insurance. The House bill would require uninsured workers to pay a tax penalty equal to 2.5 percent of adjusted gross income.[37] The Senate bill would impose either a flat penalty (which would reach $750 per noncompliant adult in 2016; the penalty for each uninsured child would be half the penalty for adults) or a penalty equal to 2 percent of taxable income. The Senate bill would waive any penalties if the cost of health insurance premiums exceeded 8 percent of income.[38]

Even with those penalties, many Americans would still find it profitable to wait until they were sick to purchase health insurance.[39] Under the House bill, singles earning more than $16,000 per year and families of four earning more than $32,000 per year would benefit financially from dropping coverage, paying the penalty, and waiting until they are sick to purchase coverage. Singles could save up to $2,600 per year, while families of four could save nearly $7,800 per year. Under the Senate bill, singles earning more than $16,000 per year and families of four earning more than $38,000 per year would face similar incentives. Singles could save as much as $2,900. Families of four could save $8,000. (See Figures 5 and 6.)

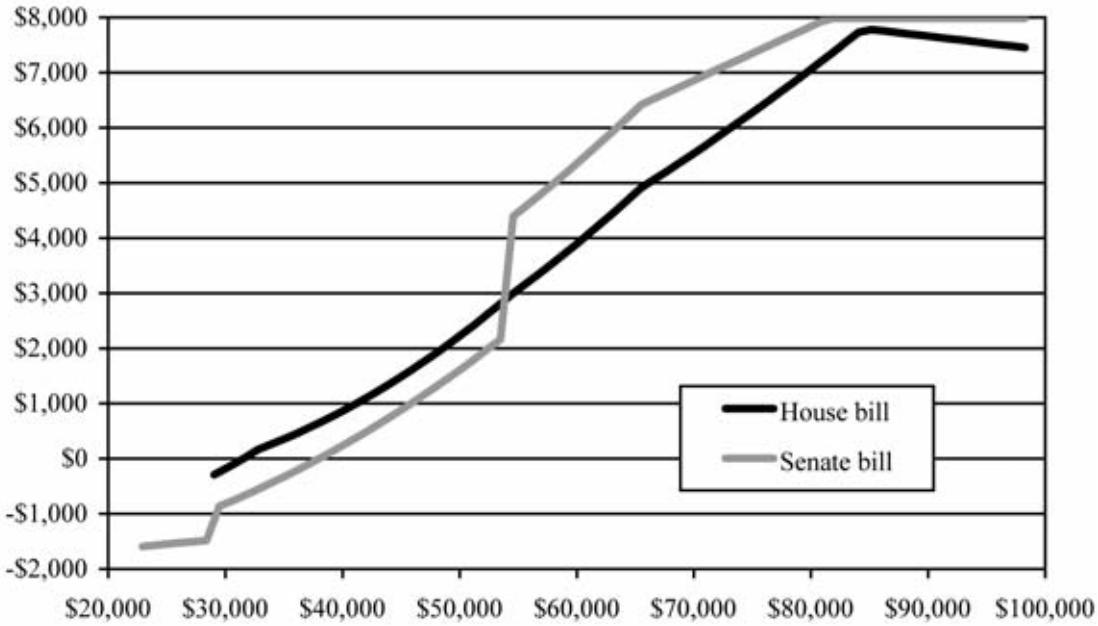
Many describe young adults who choose not to purchase health insurance as "young invincibles" who believe they will never need medical care.[40] Yet the House and Senate legislation could create cadres of "middle-age invincibles" and "of-a-certain-age invincibles" who would only purchase insurance when they fall ill.

Figure 5
Annual Savings from Dropping Coverage, Single, Childless Adults



Adjusted Gross Income (2009 dollars)

Figure 6
Annual Savings from Dropping Coverage, Families of Four



Adjusted Gross Income (2009 dollars)

Higher Premiums, Higher Taxes

The perverse financial incentives to drop coverage would destabilize health insurance markets, leading to higher premiums, higher taxes, and additional government spending.

The people most likely to respond to the incentives to drop coverage are healthier-than-average Americans.[41] As healthy individuals opt out of health insurance pools, those pools will become older and sicker. Actuaries call this "adverse selection": the people who self-select into insurance pools are sicker than average, which has an adverse effect on premiums. Those rising premiums spur additional healthy enrollees to drop their coverage, which causes premiums to climb further. Absent some intervening factor, the result is an "adverse selection death spiral."

As premiums climb higher, insured voters will predictably demand that politicians stop healthy people from gaming the system. Politicians will predictably respond by increasing the tax penalties for the uninsured and increasing subsidies to the insured, which would require additional tax increases. The potential for additional taxes and government spending suggests that the bills' actual costs would exceed its projected costs.

The Obama plan would set a low-wage trap for millions and encourage Americans *not* to purchase coverage—the opposite of the legislation's intended effect.

Conclusion

The health care bills that President Barack Obama is shepherding through Congress contain new taxes and new government subsidies, both of which would touch low- and middle-income Americans. The complexity of those tax-and-subsidy schemes makes it difficult for voters to discern whether they would be a net beneficiary or a net payer. That opacity may be deliberate.[42]

Yet supporters of President Obama's health care legislation cannot mask the reality that low- and middle-income exchange participants would face often alarmingly high effective marginal tax rates. Even if such workers would receive subsidies under the House or Senate bill, they nevertheless would keep less of every additional dollar of income than they do today. Many would see their tax bills rise even as their real incomes fell. Those perverse incentives would set a low-wage trap for millions of Americans, discouraging them from climbing the economic ladder and encouraging them to remain dependent on taxpayers. Meanwhile, the legislation's insurance regulations would encourage Americans *not* to purchase coverage—the opposite of the legislation's intended effect.

Real health care reform would not discourage Americans from purchasing health insurance, discourage low-income workers from climbing the economic ladder, or create an unstable environment that would lead to higher premiums, more government spending, and higher taxes.

Notes

The author would like to thank Victoria Payne for her invaluable assistance.

1. U.S. Congressional Budget Office (CBO), "Effects of Changes to the Health Insurance System on Labor Markets," CBO Economic and Budget Issue Brief, July 13, 2009, pp. 5–6, http://www.cbo.gov/ftpdocs/104xx/doc10435/07-13-HealthCareAndLaborMarkets.pdf.

2. CBO, *Key Issues in Analyzing Major Health Insurance Proposals*, December 2008, p. 155, http://www.cbo.gov/ftpdocs/99xx/doc9924/12-18-KeyIssues.pdf.

3. CBO, "Effects of Changes to the Health Insurance System on Labor Markets," pp. 5–6.

4. CBO, *Key Issues in Analyzing Major Health Insurance Proposals*, p. 163.

5. Gregory Mankiw, "Supply-Side Ideas, Turned Upside Down," *New York Times*, October 31, 2009, http://www.nytimes.com/2009/11/01/business/economy/01view.html.

6. See H.R. 3962, Affordable Health Care for America Act, 111th Cong., 1st sess., passed the House on November 7, 2009, http://docs.house.gov/rules/health/111_ahcaa.pdf; and the Patient Protection and Affordable Care Act (Senate bill), an amendment in the nature of a substitute to H.R. 3590, 111th Cong., 1st sess., introduced November 19, 2009, http://democrats.senate.gov/reform/patient-protection-affordable-care-act.pdf, as modified by the Manager's Amendment no. 3276 to the Reid

Substitute Amendment no. 2786, http://democrats.senate.gov/reform/managers-amendment.pdf.

7. The CBO estimates that under the House proposal, the average premium for a self-only health plan with an actuarial value of 70 percent (a "silver" plan) would be $5,300 in 2016. A similar family plan would cost $15,000. CBO, letter to the Hon. Charles B. Rangel, November 2, 2009, p. 4, http://www.cbo.gov/ftpdocs/106xx/doc10691/hr3962SubsidiesRangelLtr.pdf. The agency estimates that under the Senate bill, similar plans would cost $5,200 for singles and $14,100 for families. CBO, letter to the Hon. Evan Bayh, November 30, 2009, p. 6, http://cbo.gov/ftpdocs/107xx/doc10781/11-30-Premiums.pdf.

8. Internal Revenue Service, *1040 Instructions 2009*, pp. 77–88, http://www.irs.gov/pub/irs-pdf/i1040gi.pdf.

9. Internal Revenue Code of 1986, Sections 3101 (employee portion) and 3111 (employer portion), http://www.ssa.gov/OP_Home/comp2/F083-591.html.

10. Internal Revenue Service, pp. 43–44.

11. Internal Revenue Service, pp. 52–71.

12. Drew Altman, "Pulling It Together . . . Simple Arithmetic," Kaiser Family Foundation, September 15, 2009, http://www.kff.org/pullingittogether/091509_altman.cfm.

13. CBO, "CBO's Economic Projections for Calendar Years 2009 to 2019," http://www.cbo.gov/ftpdocs/100xx/doc10014/econproj.xls.

14. For a single, childless adult under 65 years of age, the 2008 federal poverty threshold was $11,201. For a family of four with two children, it was $21,834. See U.S. Bureau of the Census, "Poverty Thresholds for 2008 by Size of Family and Number of Related Children under 18 Years," last modified September 29, 2009, http://www.census.gov/hhes/www/poverty/threshld/thresh08.html.

15. In 1994, the CBO wrote, "The imposition of an individual mandate . . . would be an unprecedented form of federal action." CBO, "The Budgetary Treatment of an Individual Mandate to Buy Health Insurance," CBO Memorandum, August 1994, p. 1, http://www.cbo.gov/ftpdocs/48xx/doc4816/doc38.pdf. In the past, the agency has described proposed mandates as "an exercise of sovereign power." CBO, "An Analysis of the Administration's Health Proposal," February 1994, p. xv, http://www.cbo.gov/ftpdocs/48xx/doc4882/doc07.pdf. See also, Carrie Budoff Brown, "Ensign Receives Handwritten Confirmation," Politico Live Pulse, September 25, 2009, http://www.politico.com/livepulse/0909/Ensign_receives_handwritten_confirmation_.html. ("Sen. John Ensign (R-Nev.) received a handwritten note Thursday from Joint Committee on Taxation Chief of Staff Tom Barthold confirming the penalty for failing to pay the up to $1,900 fee for not buying health insurance. Violators could be charged with a misdemeanor and could face up to a year in jail or a $25,000 penalty, Barthold wrote on JCT letterhead.")

16. CBO, letter to the Hon. Evan Bayh, November 30, 2009, p. 24, http://cbo.gov/ftpdocs/107xx/doc10781/11-30-Premiums.pdf.

17. See CBO, letter to the Hon. Charles B. Rangel, October 29, 2009, http://cbo.gov/ftpdocs/106xx/doc10688/hr3962Rangel.pdf. ("CBO and JCT now estimate that the federal administrator overseeing the insurance exchanges might well allow medium-sized and large firms to purchase coverage through the exchanges.") See also, CBO, letter to the Hon. Evan Bayh, November 30, 2009, p. 13. ("In 2016, states would have to give all employers with 100 or fewer employees the option to purchase coverage through the exchanges. States could give larger employers that option starting in 2017.")

18. George Stephanopoulos, "Obama: Mandate Is Not a Tax," George's Bottom Line, September 20, 2009, http://blogs.abcnews.com/george/2009/09/obama-mandate-is-not-a-tax.html.

19. Uwe Reinhardt, "Should All Employers Be Required by Law to Provide Basic Health Insurance Coverage for Their Employees and Dependents?," in *Government Mandating of Employee Benefits* (Washington: Employee Benefits Research Institute, 1987); quoted in Lawrence Summers, "Some Simple Economics of Mandated Benefits," *American Economic Review* 79, no. 2 (May 1989): 177–83, http://bit.ly/3FZFg8.

20. Jonathan Gruber, *Public Finance and Public Policy* (New York: Worth, 2005), p. 314, http://bit.ly/4rahcn. One could argue that it is the price controls, rather than the mandate, that Gruber likens to a tax. Yet the price controls merely increase the premiums that low-risk consumers face. They do not force consumers to pay those premiums; the mandate does that. It might be inconsistent, moreover, to suggest that when price controls force you to pay more for something than the market would charge, that is a tax, but when a mandate forces you to purchase something you don't want at all, that is not a tax.

21. Summers, pp. 177–83.

22. Sherry A. Glied, "Universal Coverage One Head at a Time—The Risks and Benefits of Individual Health Insurance Mandates," *New England Journal of Medicine* 358, no. 15 (April 10, 2008): 1540–42, http://bit.ly/1kLGbN.

23. See CBO, "An Analysis of the Administration's Health Proposal," February 1994, p. xv. See also, CBO, "The Budgetary Treatment of Proposals to Change the Nation's Health Insurance System," Economic and Budget Issue Brief, May 27, 2009, http://cbo.gov/ftpdocs/102xx/doc10243/05-27-HealthInsuranceProposals.pdf.

24. See Patient Protection and Affordable Care Act (Senate bill), p. 325.

25. The bills use a modified definition of adjusted gross income, which does not affect this paper's estimates.

26. Threshold is for 2009. Tax Foundation, "U.S. Federal Individual Income Tax Rates History, 1913–2009," January 2, 2009, http://www.taxfoundation.org/publications/show/151.html.

27. (0.15) x ($8,400) - (0.1) x ($8,350) = ($1,260) – ($835) = $425.

28. These marginal tax rates are sensitive to the size of the margin. The margin used here is 5 percent of the federal poverty level. See also Figures 1 and 2.

29. See H.R. 3962; and the Patient Protection and Affordable Care Act (Senate bill), p. 241.

30. In most cases, the phase-out of the premium tax credit does not have any additional impact on a worker's effective marginal tax rate; the effect is captured by the mandate tax, with one exception. A worker's marginal mandate-tax rate falls to zero once her mandate-tax liability reaches the value of the minimum benefits package the legislation would require her to purchase. That is, the legislation would not require her to devote any additional income to health insurance. However, if she increases her income but does not purchase any additional coverage, her premium tax credit falls to zero. That loss of the premium tax credit does influence her effective marginal tax rate.

31. Tax Foundation, "If Health Surtax Is 5.4 Percent, Taxpayers in 39 States Would Pay a Top Tax Rate over 50%," Fiscal Fact no. 178, July 14, 2009, http://www.taxfoundation.org/publications/show/24863.html.

32. See Patient Protection and Affordable Care Act (Senate bill), p. 255.

33. CBO, "Effects of Changes to the Health Insurance System on Labor Markets," p. 6.

34. See generally, Victor Fuchs, "Cost Shifting Does Not Reduce the Cost of Health Care," *Journal of the American Medical Association* 302, no. 9 (September 2, 2009): 999-1000, http://jama.ama-assn.org/cgi/content/short/302/9/999. ("Almost every political pronouncement now emphasizes cost reduction as a central object of health care reform. The policy recommendations that follow, however, frequently aim at cost shifting rather than cost reduction. . . . To see the irrelevance of shifting for cost reduction, consider the proposal to prohibit health insurance companies from varying premiums according to enrollee's health status. This obviously reduces premiums for the sick but, not so obviously, also increases premiums for the healthy. Such a shift . . . does nothing to reduce the real cost of care. . . . A subsidy is another example of a so-called cut in the cost of care, but also is just cost shifting. A subsidy reduces the cost for low-income eligible individuals by shifting the cost to higher-income taxpayers.")

35. See Michael F. Cannon, "Yes, Mr. President, a Free Market Can Fix Health Care," Cato Institute Policy Analysis no. 650, October 21, 2009, http://www.cato.org/pubs/pas/pa650.pdf.

36. See Aaron Yelowitz, "ObamaCare: A Bad Deal for Young Adults?" Cato Institute Briefing Paper no. 115, November 5, 2009, http://www.cato.org/pubs/bp/bp115.pdf.

37. H.R. 3962, p. 297, http://docs.house.gov/rules/health/111_ahcaa.pdf. The House bill would also impose an 8-percent payroll tax penalty on employers who do not comply with that bill's employer mandate. H.R. 3962, p. 275. Since employers finance such levies by reducing wages, in effect, the House bill would additionally impose a 10.5-percent payroll tax on uninsured adults who work for noncompliant employers.

38. Patient Protection and Affordable Care Act (Senate bill), p. 326.

39. The CBO writes that the Senate bill "would establish an annual open enrollment period for new nongroup policies . . .which would limit opportunities for people who are healthy to wait until an illness or other health problem arose before enrolling." CBO, letter to the Hon. Evan Bayh, November 30, 2009, p. 19. Economist Martin Feldstein posits that short-term insurance policies would emerge to cover medical expenses that arise between the onset of need and the purchase of health insurance. Martin Feldstein, "Obamacare's Nasty Surprise," *Washington Post*, November 6, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/11/05/AR20

09110504327.html.

40. See Yelowitz.

41. See Yelowitz.

42. See Nobel laureate James M. Buchanan's restatement of Italian economist Amilcare Puviani's "fiscal illusion" hypothesis: "The ruling group attempts, to the extent that is possible, to create fiscal illusions, and these have the effect of making taxpayers think that the taxes to which they are subjected are less burdensome than they actually are. At the same time, other illusions are created that make beneficiaries consider the values of public goods and services provided them to be larger than may actually be the case. The various institutions of taxing and spending are so organized as to create this set of illusions." James M. Buchanan, *Collected Works of James M. Buchanan, Vol. 4—Public Finance in Democratic Process: Fiscal Institutions and Individual Choice* (Indianapolis: Liberty Fund, 1999),

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