Individual Mandate Would Impose High Implicit Taxes on Low-Wage Workers

TOPICS: HEALTH COSTS

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In their attempt to expand health insurance coverage, House and Senate Democrats are poised to make the American dream less accessible to low-income Americans by h
them with higher implicit tax rates than even multi-millionaires face.

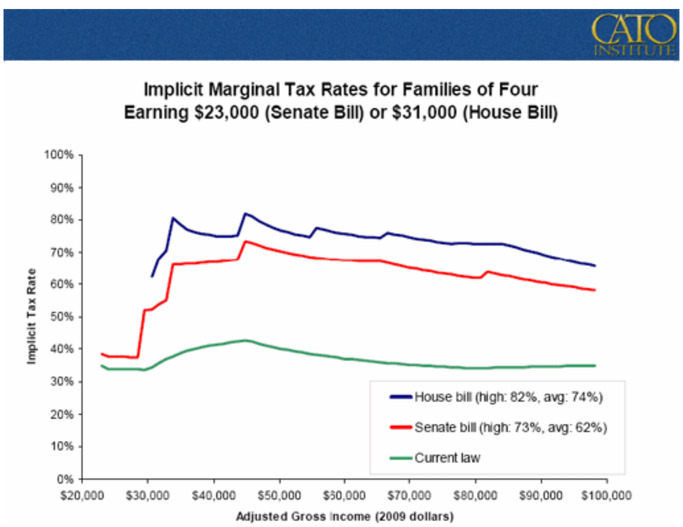
In a new study, I found those implicit marginal tax rates would hover near 70-80 percent over broad ranges of income. In many cases, they would exceed 100 percent, finan
penalizing those who try to climb the economic ladder.

The legislation would cause taxes and health insurance premiums to climb higher still, by creating huge financial incentives for healthy people to drop out of the market.

Two features of each bill would combine to impose punitive implicit tax rates on low-income Americans.

The first is an "individual mandate," which would force Americans to purchase health insurance whether they want it or not, under penalty of fines and/or imprisonment. Pres
Obama's economic advisors and other Democratic economists acknowledge that the individual mandate is essentially a tax.

Each bill would require low- and middle-income Americans to pay an increasing percentage of their income toward health insurance. In so doing, the bills dispense with the
heretofore universally accepted principle that marginal tax rates should only apply to income at the margin. As a result, the "mandate tax" creates marginal rates as high as
percent – and that's for people making just $15,000 per year.



The second feature is the health insurance subsidies tied to the individual mandate. Those subsidies would disappear as income rises. Under the House bill, families of four
an annual income around $43,000 can lose a $1,000 subsidy just by earning $1 over the eligibility cutoff.

The non-partisan Congressional Budget Office writes, "That effect, known as an 'implicit tax,' can lead people to work fewer hours than they otherwise would, in the same w
that income and payroll tax rates do." It may also discourage them from "working harder in the hope of winning raises; accepting new positions or responsibilities with highe
compensation; or investing in their future earning capacity through education, training, or other means."

The disincentives to climb the economic ladder would be severe:

• Under the Senate bill, a single adult who scrapes her way from $12,000 to $17,000 in annual earnings would only get to keep one out of every three of those additional $5 dollars – an implicit tax rate of 66 percent.

• Under the House bill, a family of four that struggles to climb from $30,000 to $45,000 would only get to keep $3,000 of that additional $15,000 – an implicit tax rate of more 80 percent.

In many cases, implicit marginal tax rates would exceed 100 percent:

• Under the Senate bill, adults with annual earnings of $14,560 who earn an additional $560 would see their total income fall by $200, due to higher taxes and reduced subs

• Under the House bill, a family of four starting at $43,670 that earns an additional $1,100 would see its total income fall by $870.

Multi-millionaires would face tax rates no higher than 47.9 percent under these bills. In contrast, the Senate bill would create at least three "cliffs" where families of four woul implicit marginal tax rates greater than 100 percent. The House bill would create at least four.

Many low- and middle-income families will decide the American dream is no longer worth it. If work no longer pays, who could blame them?

These high implicit tax rates are not a minor problem that can be fixed with a quick amendment. They are an inherent part of the Democrats' strategy of expanding coverage shifting costs, rather than reducing costs.

The perverse incentives don't stop there.

Americans would have to pay a penalty if they lack insurance, but the penalties are so small that healthy individuals could save as much as $3,000 per year by going uninsu while families of four could save $8,000. Those savings would grow over time. Each bill would effectively eliminate any penalty for "going bare" by forcing insurers to sell to t uninsured at standard premiums whenever they fall ill.

When healthy people respond to those incentives by abandoning insurance pools, premiums will rise for those who remain. That will create pressure for even more governm spending and higher taxes.

Congress should apply the brakes to this locomotive. Americans deserve time to figure out what's going on inside these 2,000-page bills.

Michael F. Cannon (@mfcannon) is director of health policy studies at the Cato Institute and author of ObamaCare's Prescription for Low-Wage Workers: High Implicit Tax Higher Premiums , released today by the Cato Institute.

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