Are the Obamacare repeal tax cuts just giveaways to the rich?

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In the debate over the repeal of Obamacare, much opposition has focused on the suggestion that the Republicans' proposed cuts in subsidies and coverage aim to fund big tax cuts for high-income taxpayers.

The House and Senate health care bills adjust or repeal many Obamacare taxes, but the main ones being castigated as "handouts to the rich" are the elimination of the 3.8% Affordable Care Act (ACA) hike in the tax rate on investment income and the 0.9% increase in the Medicare tax on wage and salary income for high-income earners (over $200,000 for an individual or $250,000 for a family). The Tax Policy Center has estimated that, by 2026, people who earn $5 million or more would, on average, see their taxes cut by almost $250,000.

This criticism of the Republican bills is understandable but wrongheaded.

The economically thoughtful way to evaluate government spending and taxes involves two steps; first determining whether the spending is justified and a good use of government resources, setting aside how it's paid for, and secondly, deciding on the best way to raise revenue to pay for that spending.

The fact that taxes that distort the functioning of the economy will be necessary to pay for government spending is a cost of that expenditure. But otherwise, "sources and uses" are separate issues.

How to pay

So, taking the amount of spending as given, whether under the ACA, the American Health Care Act (AHCA) -- or the Better Care Reconciliation Act (BCRA), which taxes should be used to pay for it?

Standard economics says that high marginal tax rates reduce economic activity by reducing the incentive to save and work. And the ACA taxes on investment savings and high incomes are exactly backwards from this perspective; they raise the tax burden on savings and working for high income taxpayers, the ones most likely to alter their behavior in response to such taxes, thereby slowing economic growth which affects everyone.

There is considerable evidence that cutting taxes of this kind is a plus -- such cuts boost the economy in the short term, and perhaps to a modest degree over the longer haul.

Thus repeal of the ACA investment and income taxes makes sense, whatever the fate of Obamacare more broadly.

Eliminating these taxes does imply higher deficits, even though the cuts will stimulate economic activity. The lost revenue is estimated by the Congressional Budget Office at around $30-35 billion per year.

Cadillac tax

How should Congress make up for the lost revenue? By raising taxes that improve rather than harm economic efficiency. The obvious example is the so-called Cadillac tax on high-cost health insurance policies.

This tax is an imperfect antidote to the current tax exemption for employer-paid health insurance premiums. By waiving taxes on the premiums, the current law subsidizes health insurance for those who obtain coverage through their employer, so it encourages purchase of overly generous provisions like low deductibles.

The public hates high deductible plans, but they do exactly what insurance is supposed to do -- protect the insured from large, unpredictable expenses, not reimburse people for routine or moderate health spending. This subsidy incentivizes care for which the costs exceed the health benefits, and this increased demand puts upward pressure on prices and therefore spurs health cost inflation.

The best fix of this feature of the tax code would be repeal of the tax exemption. According to the Office of Management and Budget, that would generate more than $200 billion per year in additional revenue, while making the tax and health care systems more efficient.

Repeal of the full exemption, alas, faces stiff opposition. Not surprisingly, therefore, the ACA did not schedule implementation of the Cadillac tax, which goes only part of the way toward fixing this problem, until 2018, four years after the ACA took effect. Congress later pushed this to 2020. The House and Senate Republican repeal bills postpone implementation until 2025 and 2026, respectively.

Other changes to the tax code, unrelated to health care, would generate more revenue while improving economic efficiency -- elimination of the home mortgage interest deduction is a major example.

Calm discussion of the House and Republican health bills, therefore, suggests that individual features -- such as repeal of highly distorting taxes -- make sense as good economics; they are not merely giveaways to the rich.

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