

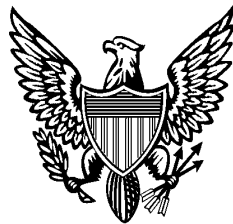
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**AMERICA'S AFFORDABLE HEALTH CHOICES
ACT OF 2009**

R E P O R T
OF THE
COMMITTEE ON WAYS AND MEANS
ON
H.R. 3200
Together with
DISSENTING AND ADDITIONAL VIEWS



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D. Macroeconomic Impact Analysis

In compliance with clause 3(h)(2) of rule XIII of the Rules of the House of Representatives, the staff of the Joint Committee on Taxation provides the following macroeconomic analysis of H.R. 3200, “America’s Affordable Choices Act of 2009,” as reported by the Ways and Means Committee.

Summary

The analysis examines the effects of the different parts of the bill on incentives that could affect either long-run growth or short-term fluctuations in economic activity, progressively incorporating three aspects of the bill in the analysis. All of the analysis is of expected effects within the standard Federal ten-year budget period. The first section looks at changes to the Internal Revenue Code in Title IV of the bill. Next, the effects of low income subsidies for the purchase of health insurance are added to the analysis. Finally, net changes in spending on Medicare and Medicaid are incorporated to provide a picture of the fiscal impacts of the bill as a whole. This analysis uses the Joint Committee staff’s Macroeconomic Equilibrium Growth (“MEG”) model to evaluate these effects.¹ The Joint Committee staff does not have a model designed to analyze possible efficiency, productivity, or labor market impacts of changes in the health sector of the economy, and thus this analysis will not include consideration of such impacts.²

Tax and expenditure policy can affect economic growth through several different channels. Long-term growth is determined by the availability of labor, capital and materials for the production process. In addition, in the short-run, during periods when available resources are not being fully used, growth can also be affected by changes in demand for goods and services. Changes in taxes and government spending can affect the availability of labor and capital by influencing peoples’ incentives to work, save, and invest. Fiscal policy, or net changes in Federal debt, can influence long-run growth to the extent that it constrains the amount of capital available for private investment; and, it can influence short-run demand by affecting the amount of after-tax income people have to spend. In terms of the tax policy effects of the bill, H.R. 3200 contains provisions that slightly reduce incentives to work, save, and invest, resulting in a projected slight decline in GDP due to these incentives. From a fiscal policy standpoint, the bill would also result in a slight increase in Federal government debt, which may further reduce, or crowd out, the availability of funds for private investment.

¹ Descriptions of the macroeconomic equilibrium growth model and other models used by the Joint Committee staff may be found in Joint Committee on Taxation, *Overview of the Work of the Staff of the Joint Committee on Taxation to Model the Macroeconomic Effects of Proposed Tax Legislation to Comply with House Rule XIII.3(h)(2)*, JCX-105-03, December 22, 2003, and *Background Information about the Dynamic Stochastic General Equilibrium Model Used by the staff of the Joint Committee on Taxation in the Macroeconomic Analysis of Tax Policy*, JCX-52-06, December 14, 2006.

² For a thorough discussion of the issues and empirical evidence of the likely impacts of reforms similar to those in this bill, see Congressional Budget Office, *Key Issues in Analyzing Major Health Insurance Proposals*, December, 2008, and *Effects of Changes to the Health Insurance System on Labor Markets*, Economic and Budget Issue Brief, July 13, 2009.

Models and data

The primary focus of Joint Committee staff macroeconomic analysis is to determine the effects of changes in tax policy on the economy. In order to determine the effects of tax policy on average and marginal tax rates, the Joint Committee staff uses large microsimulation models based on large samples of individual, corporate, and other income tax returns provided by the Statistics of Income division of the Internal Revenue Service.³

To analyze the effects of these tax policy changes on the economy, the current analysis relies on the Joint Committee's Macroeconomic Equilibrium Growth model.⁴ The MEG model is a reduced form macroeconomic model with neoclassical foundations and myopic expectations. Peoples' willingness to work is determined by their after-tax wages and by the after-tax rate of return on additional hours of work. Changes in average and marginal tax rates affect these decisions. These labor supply decisions are modeled separately for four groups: low income primary workers, low-income secondary workers, high income primary workers, and high income secondary workers. Investment is determined by the after-tax return to capital, which is affected by changes in taxes on business and investment income. The taxation of corporate profits, proprietors' income, dividends, capital gains, and rents are each separately modeled in the MEG model.

The MEG model can be operated in an equilibrium mode, or used to simulate disequilibrium growth paths, by varying monetary policy assumptions. The equilibrium mode assumes the Federal Reserve Board omnisciently counteracts any short-term demand effects of fiscal policy to maintain the existing equilibrium. The disequilibrium growth path reflects the effects of short-term fluctuations in demand. An increase in government spending or reduction in tax rates, all else equal, would increase the amount of disposable income available to consumers, and would generally be expected to increase consumer demand. In contrast, an increase in taxes or decrease in spending or transfer payments would reduce disposable income, and thus would be likely to decrease consumer demand. Often, the Federal Reserve Board ("Fed") influences the interaction between fiscal policy and fluctuations in demand for goods and services by managing interest rates and the money supply.

The following analysis is presented using alternate assumptions about whether the Federal Reserve Board intervenes to influence the demand consequences of the policy. In the

³ These models are described in Joint Committee on Taxation, Overview of Revenue Estimating Procedures and Methodologies Used by the Staff of the Joint Committee on Taxation, JCX-1-05, February 2, 2005

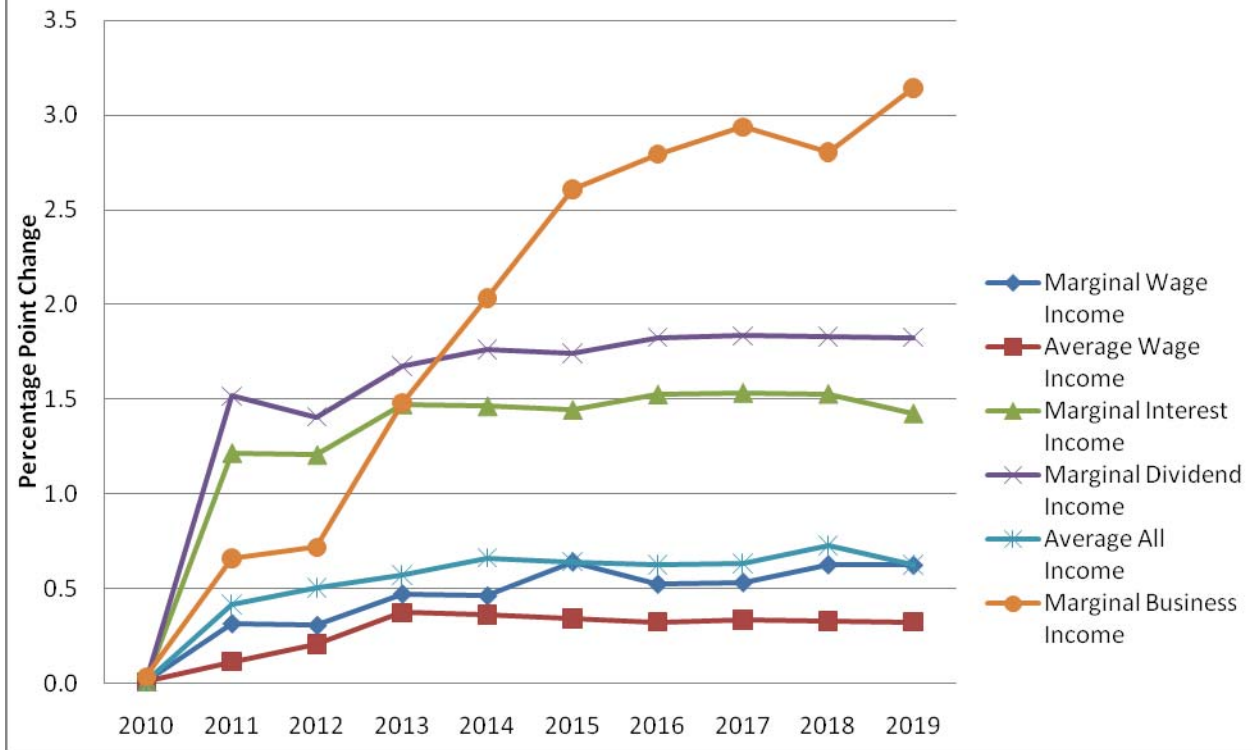
⁴ To get a more complete picture of the range of possible macroeconomic effects from policy changes, it would generally be optimal to use additional models that are designed to examine the long-term growth effects of tax policy in a computable, general equilibrium framework, with either partial or perfect foresight. The Joint Committee staff has used such models in past analyses. But given the current size and projected present-law growth of deficits, the use of such models would require making very strong counterfactual assumptions about present law fiscal policy that may distort the analysis. That is, there would have to be an assumption that the Federal debt is reduced to sustainable levels in the foreseeable future in a computable general equilibrium framework. Because the policy being implemented either reduces the debt (in the case of the revenue provisions analyzed by themselves) or is close to deficit neutral (in the case of the revenue items combined with the spending provisions), in a simulation that assumed some additional provision that would reduce Federal government debt by the required amount, the effects of the debt-closing policy would overwhelm the effects of the provision being analyzed.

first case, the Federal Reserve Board is assumed to swiftly counteract any demand effects of the policy. In the second case, the Federal Reserve Board is assumed not to change its monetary policy at all. Generally, the Federal Reserve Board would be expected to counter the demand effects of a policy if the policy were likely to accelerate a swing in the business cycle. If the policy is counter-cyclical, or neutral, the Federal Reserve Board would be less likely to intervene. Because of current economic conditions, with the economy in a recession and the Federal Reserve Board actively engaged in providing liquidity to the economy to encourage economy expansion, it is difficult to predict how much flexibility it would have in reacting to major fiscal policy initiatives in the near future. However, since most of the provisions of H.R. 3200 would not take effect until 2013, this consideration should be of less relevance than it would be in the current year.

Analysis

Effects of the revenue provisions.—Title IV of H.R. 3200 includes several provisions to provide incentives to increase health insurance coverage, and several provisions to raise revenues to finance the increases in health insurance coverage. The coverage-related revenue provisions include taxes on certain individuals who fail to obtain coverage, and taxes on employers who fail to offer health insurance to their employees or who offer insurance that is not deemed “affordable” and whose employees obtain subsidized coverage through the new health insurance exchange. The following analysis first examines the macroeconomic effects of these revenue provisions. The provisions are projected to result in a net increase in Federal revenues of approximately \$790 billion between 2010 and 2019. Figure 1 illustrates the effects of these provisions on aggregate average and marginal tax rates on various sources of income. While the average and marginal tax rates of four different labor groups are separately modeled, for ease of exposition, Figure 1 shows combined wage tax effects. These rates are calculated including some of the behavioral responses to tax changes (such as timing, portfolio effects, and other shifting of income to minimize taxation) that are included in conventional Joint Committee staff revenue estimates.

Figure 1. - Effect of Tax Title on Marginal and Average Tax Rates on Certain Types of Income



The most significant of the revenue provisions in this bill is the imposition of a surcharge on adjusted gross incomes (“AGI”) above \$350,000 for joint filers and \$280,000 for single filers, and heads of households. The surcharge is graduated. In 2011, the surtax begins at a rate of one percent on amounts up to \$500,000 for joint filers, and \$400,000 for individual filers, and increases to 5.4 percent on amounts above \$1 million and \$800,000 respectively. In 2013, the surtax rates range from two percent to 5.4 percent. Average and marginal tax rates on wages of high income earners are increased by roughly equivalent amounts due to this provision. The increase in average tax rates reduces disposable income, providing some incentive to increase labor supply, while the increase in marginal tax rates on wages reduces the after-tax earnings of additional labor; on net the tax changes provide an incentive for affected taxpayers to reduce their labor supply. Because the surtax applies to all income above the AGI threshold, it also taxes income generated from business activities of sole proprietors, partners, S-Corporation shareholders, and other individuals receiving income from capital. The increased tax on business income reduces the return to business activities, thus reducing incentives to invest in business activities.

Additional provisions affecting individual taxpayers include a penalty on individuals with income above the income tax filing threshold who fail to purchase health insurance, a provision to conform the definition of qualified medical expenditures for Flexible Spending Arrangements, Individual Health Arrangements, Health Savings Accounts, and Medical Savings Accounts to the

definition provided under Code section 223, and a provision to provide for certain health benefits currently applicable to a taxpayer’s spouse and dependents to certain other beneficiaries. The net effect of these provisions is to slightly increase average and marginal tax rates on individual income.

Additional business-related provisions that are part of health reform include employer responsibility payments assessed on employers with payrolls above \$250,000 in 2013 that fail to provide health insurance for their employees, and tax credits for up to 50 percent of the cost of employee health insurance by businesses with fewer than 26 employees and average wages less than \$40,000. Additional business tax provisions that contribute to raising revenues include delaying the implementation of worldwide interest allocation for multinational firms until 2020, limiting eligibility for reduced withholding under certain treaties, and codification of the economic substance doctrine for assessing whether certain transactions should generate tax liabilities. The net effect of these additional business tax provisions is to slightly increase average and marginal tax rates on businesses with more than 25 employees.

Table 1 shows the effects of the revenue provisions contained in Title IV of H.R. 3200 on economic growth, measured as percent changes in Gross Domestic Product (“GDP”) relative to present-law baseline projections, and other key macroeconomic aggregates.

Table 1.—Effects of Revenue Provisions Percent Change Relative to Projected Present Law Levels

	Fed Counters Demand Response [Percent]		No Fed Reaction [Percent]	
	2010-14	2015-19	2010-14	2015-19
Nominal GDP	-0.1	-0.4	-0.4	-1.5
Real GDP	-0.1	-0.2	-0.2	-0.3
Real producers' capital stock	-0.2	-0.6	-0.2	-0.7
Labor force participation	-0.1	-0.1	-0.1	-0.1
Employment	-0.1	-0.2	-0.2	-0.3
Real consumption	-0.3	-0.5	-0.4	-0.7
Change in long-term interest rates (basis points)	-3	-32	-5	-39
Receipts feedback (percent change in receipts due to change in GDP)	-0.1	-0.4	-0.2	-0.6

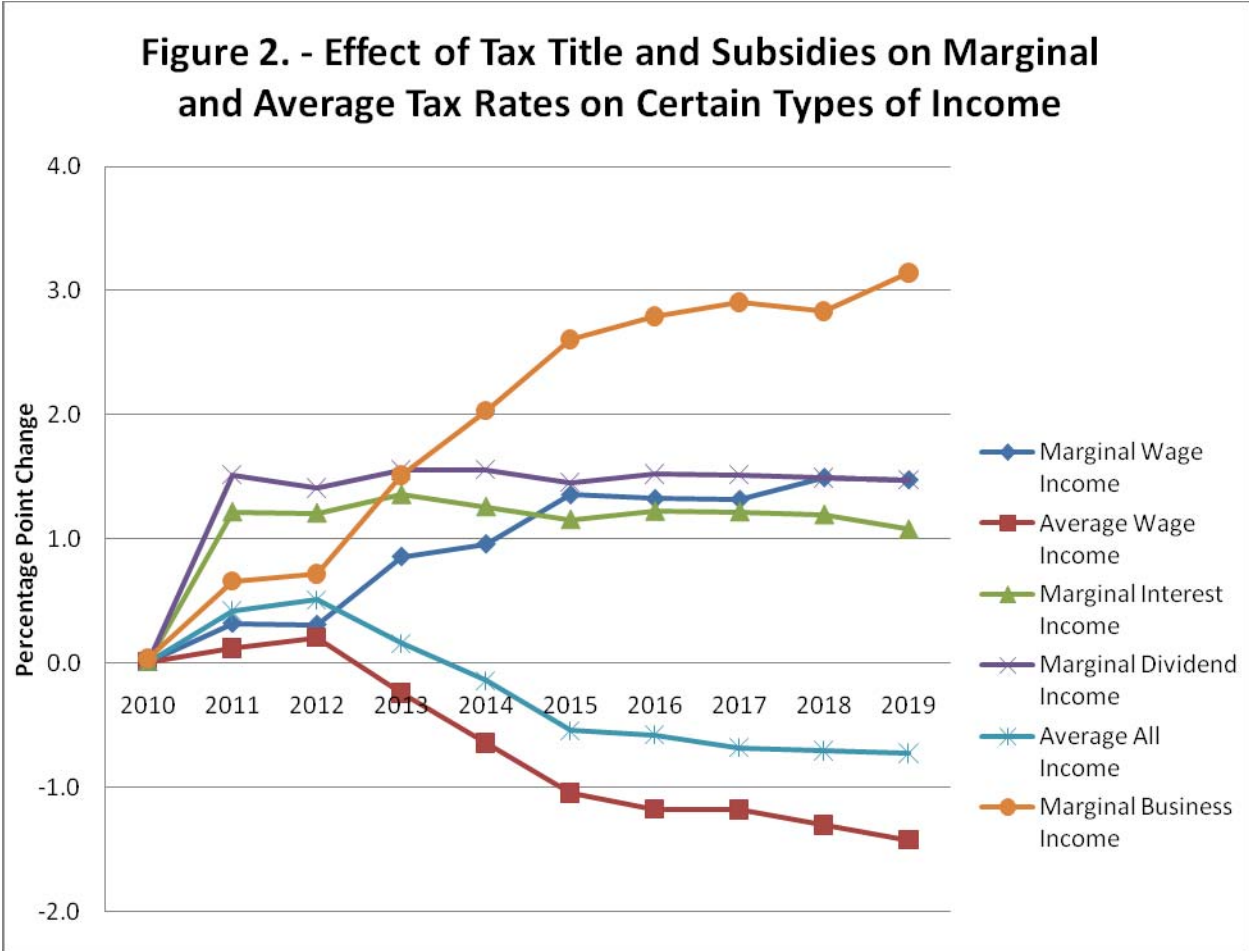
Consistent with the negative incentives for both labor supply and business investment described above, relative to present law, labor force participation is projected to fall by about 0.1 percent relative to the baseline, and business capital stock is projected to fall by 0.2 percent in the early years, and by up to 0.7 percent in the longer run. Because the policy reduces disposable

income, it also exerts a downward pressure on demand. Nominal GDP is projected to fall by 0.1 to 0.4 percent in the 2010-2014 and by 0.4 percent to 1.5 percent in 2015-2019, depending on whether the Federal Reserve Board counteracts the downward pressure on demand. Real (inflation-adjusted) GDP would decline by 0.1 to 0.4 percent in 2010-14 and 0.2 to 0.3 percent in 2015-19. Consumption is also projected to fall relative to the baseline by 0.3 to 0.4 percent in 2010-14 and 0.5 to 0.7 percent in 2015-19. One positive effect of these provisions on the economy is a decline in long-term interest rates by up to 39 basis points in the long run due to the reduction in Federal debt. Because of the decline in GDP relative to the baseline, the taxable income base is reduced, and receipts would be 0.1 percent to 0.6 percent lower taking growth effects into account.

Effects of revenue provisions and health insurance subsidies combined.—Beginning in 2013, Title II of H.R. 3200 also provides for subsidies for the purchase of certain qualified health insurance through new health insurance exchanges. These subsidies, referred to as “affordability credits,” along with out-of-pocket cost sharing assistance are available to individuals and families with adjusted gross incomes below 400 percent of the Federal poverty level. The affordability credits and subsidies, cost approximately \$840 billion from 2010-2019. On net, the subsidies and tax provisions together increase Federal government debt by approximately \$50 billion from 2010-2019.

Because of the way the affordability credits are structured, they have incentive effects similar to those of refundable tax credits. The subsidies themselves increase disposable income, just as reductions in average tax rates would for eligible individuals, reducing incentives to work. Because the credits are phased out by income levels, they have the same incentive effect with respect to income-producing activities as increasing marginal tax rates for eligible individuals - reducing the return to additional income generation, and thus reducing incentives to work and invest. The affordability credits are designed to assist low-income individuals in purchasing qualified health insurance in compliance with a requirement that everyone have health insurance coverage. The increased health coverage could lead to increased consumption of medical services, which could in turn lead both to changes in individual health status and productivity. In addition, changes in demand for health care services within the context of the health market reforms included in the bill could produce significant changes in the health service delivery system, which could impact the efficiency of the health sector and/or the productivity of the population. The availability of subsidized, risk-pooled health insurance outside of the employment context could also affect people’s decisions regarding job changes and retirement. Such effects are beyond the scope of this analysis.

Figure 2 shows the combined effects of the revenue provisions of Title IV and the subsidy provisions of Title II of H.R. 3200. Overall, the effective marginal rate on aggregate wage income continues to increase, while the aggregate average rate declines. In particular, effective marginal tax rates increase for individuals qualifying for the subsidy (whose income is below 400 percent of the Federal poverty level), and for those subject to the surtax (whose adjusted gross income is above \$350,000). While the average rate for those subject to the surtax increases, effective average rates (accounting for the subsidy) for subsidy-eligible individuals decrease by a greater amount.



Similarly, Table 2 shows the combined macroeconomic effects of these two Titles of H.R. 3200. Relative to the present law baseline, real GDP is projected to decrease by slightly more from 2015-19, 0.4 percent under the combined tax and subsidy proposal than the with the revenue provisions alone. The combination of tax increases and affordability credits is projected to reduce labor force participation by 0.3 percent between 2015 -2019, more than the effects of the revenue provisions alone. Employment is also projected to be reduced relative to what it would be under present law. Because Federal debt is only slightly increased under this scenario, there is little change in long-term interest rates; thus more private investment is displaced by public debt in this scenario relative to the tax provisions alone, and producers' capital stock falls by 0.2 percent in 2010-14 and 1.3 percent in 2015-2019. Conversely, because disposable income is not being contracted, there is little short-run demand effect, with little difference between the effects of the proposal on nominal versus real GDP. The decline in GDP and associated macroeconomic aggregates relative to the present law baseline would result in receipts decreasing by 0.1 to 0.5 percent.

**Table 2.—Effects of Tax Provisions and Exchange Subsidies Percent Change
Relative to Projected Present Law Levels**

	Fed Counters Demand Response [Percent]		No Fed Reaction [Percent]	
	2010-14	2015-19	2010-14	2015-19
Nominal GDP	-0.1	-0.4	-0.3	-0.3
Real GDP	-0.1	-0.4	-0.2	-0.2
Real producers' capital stock	-0.2	-1.3	-0.2	-1.2
Labor force participation	-0.1	-0.3	-0.1	-0.3
Employment	-0.1	-0.3	-0.2	-0.1
Real consumption	-0.2	-0.3	-0.2	-0.3
Change in long-term interest rates (basis points)	-1	-3	-5	-2
Receipts feedback (percent change in receipts due to change in GDP)	-0.1	-0.5	-0.2	-0.4

Fiscal effects of the entire bill.—Finally, H.R. 3200 makes many changes to the Medicare and Medicaid programs. The net effect of these changes, in combination with the revenue provisions and the exchange subsidies, is to increase the Federal deficit by approximately \$220 billion from 2010-2019. The Joint Committee staff models the Medicaid and Medicare changes as changes in untaxed transfer payments received by taxpayers. As with the affordability subsidies for the purchase of health insurance, these program changes could have effects on the health care delivery system, but these effects are not incorporated in this analysis.

Because any income phase-outs associated with the changes to Medicare and Medicaid have not been modeled, the changes in effective marginal tax rates and average tax rates in this scenario are the same as in the second scenario, shown in Figure 2 above. Only the net effects of these changes on personal disposable income and Federal government debt are considered in this analysis. Table 3 shows the growth effects of the combined revenue provisions, affordability subsidies, and changes to Medicare and Medicaid.

**Table 3.—Effects of Tax Provisions, Subsidies, and Changes in Other Outlays
Percent Change Relative to Projected Present Law Levels**

	Fed Counters Demand Response [Percent]		No Fed Reaction [Percent]	
	2010-14	2015-19	2010-14	2015-19
Nominal GDP	-0.1	-0.4	-0.2	0.1
Real GDP	-0.1	-0.4	-0.1	-0.1
Real producers' capital stock	-0.2	-1.5	-0.2	-1.4
Labor force participation	-0.1	-0.3	-0.1	-0.3
Employment	-0.1	-0.3	-0.1	0.0
Real consumption	-0.2	-0.2	-0.3	0.0
Change in long-term interest rates (basis points)	1	8	-1	11
Receipts feedback (percent change in receipts due to change in GDP)	-0.1	-0.6	-0.2	-0.3

Because effective tax rates are the same in this scenario as in the one above, incentives for work remain the same, and labor force participation is again projected to decline relative to the present law baseline by 0.1 percent from 2010-14 and by 0.3 percent in 2015-19. One noticeable difference between this scenario and the others is the increase in long-term interest rates that results from the increase in Federal government debt. The increased debt crowds out more private investment, reducing business capital stock by up to 1.5 percent in 2015-19. The increase in disposable income also leads to more short-term demand pressure, resulting in smaller declines from the baseline in GDP in the case where the Fed does not attempt to counteract the demand effect. Changes in GDP continue to reduce Federal receipts by modest amounts, by 0.1 to 0.2 percent in 2010-14 and 0.3 to 0.6 percent in 2015-19.

Conclusion.—The revenue, subsidy, and overall fiscal effects of H.R. 3200 create moderately negative growth incentives through raising marginal tax rates on labor and capital and through the interest-rate increase owing to increased deficits. When the revenue provisions are considered alone, the negative incentive effects are somewhat offset by the reduction in long run interest rates.