GALEN INSTITUTE

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Questions and Answers about the Democrats' Proposal to Expand Obamacare Subsidies

On February 23, 2021, the Galen Institute published an analysis by senior research fellow Brian Blase on the impact of the Democrats' proposal to expand Affordable Care Act (ACA) subsidies. "Expanded ACA Subsidies: Exacerbating Health Inflation and Income Inequality."

The study finds that the proposed ACA subsidies are subsidies are much larger for older people and for those with higher incomes. The proposed subsidy expansion exacerbates tax inequities, substantially replaces private spending with government spending, reduces incentives for work and productivity, and significantly adds to already unsustainable family and government health care expenditures.

Below is a summary of the analysis:

Q: Why are the exchanges a failure so far?

A: The Congressional Budget Office (CBO) and a variety of research organizations originally projected there would be 25 million exchange enrollees in 2019. It turns out, there were only about 10 million enrollees—60 percent below expectations. The reason: the ACA caused individual market premiums and deductibles to skyrocket and reduced most peoples' choices of coverage.

Despite $50 billion in annual ACA subsidies, there has been no increase in private health insurance enrollment, despite net spending a staggering $25,000 per new enrollee. Individual market enrollment is up by two million people, but the ACA also caused about a drop of two million people in employer-sponsored insurance (ESI). Since the federal government provides tax subsidies worth about $2,000 per enrollee with ESI, federal deficits have increased by $46 billion a year for no increase in private insurance coverage. The entire net coverage gain through the ACA is because of the law's Medicaid expansion.

Q: How would the Democrats' proposal increase ACA subsidies?

A: The subsidies, or premium tax credits (PTCs) in The American Rescue Plan Act of 2021 are structured to limit the amount of income that households must pay for a benchmark plan, i.e. the second-lowest-cost silver plan in a rating area. The

amount of the PTC declines as household income increases. People who qualify for a PTC can then use their subsidies toward the purchase of any plans. For the vast majority of enrollees, the PTC is advanced each month to the insurance company that is selected by the enrollee. In 2020, 86 percent of exchange enrollees received a PTC. And in the median state, the PTC amount covered more than 80 percent of the total premium.

The relief bill, introduced by House Democrats on February 19, 2021, decreases the amount of income that people must pay for a benchmark plan and removes the income cap on subsidy eligibility in 2021 and 2022. Right now, subsidies are available only to people with income below 400 percent of the federal poverty line.

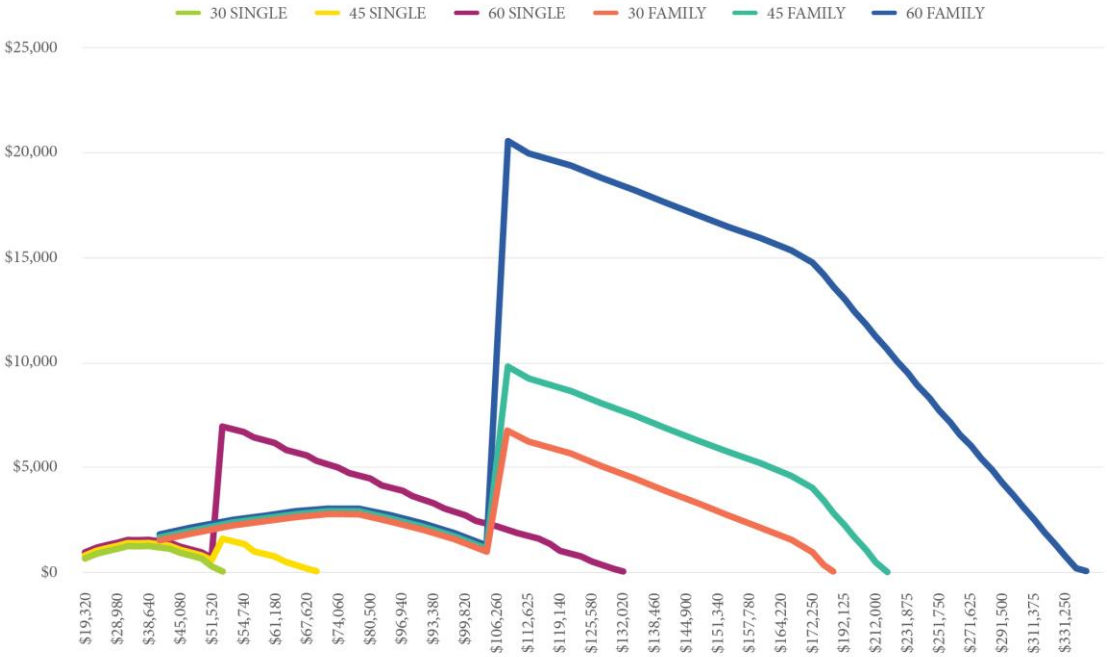
Q: How are the new subsidies distributed?

A: Richer people get far more assistance from this policy than poorer ones. For example, using national average premiums, a 60-year-old couple with two kids making $212,000 receives a benefit of $11,209. If they earned $159,000, they would qualify for a PTC of $15,868. If they earned $265,000 a year, they would qualify for a PTC of $6,551.

The PTCs would be larger in areas of the country where premiums are above the national average and less in areas of the country where premiums are below the national average. In contrast to the large benefit received by wealthy households, a family-of-four making $39,750 regardless of the age of the couple receives a benefit of $1,646 from this proposal. As such, the Democrats' proposal will significantly worsen income inequality. As the figure below shows, households with incomes just above 400 percent of the FPL receive the most substantial benefit and that benefit phases out, but remains substantial well up the income scale, particularly for older households. In some parts of the country, households with more than $500,000 would now qualify for PTCs. For example, a 64-year-old couple in Kay County, Oklahoma earning $500,000 per year, which faces a benchmark premium of $49,897 a year, would qualify for a PTC of $5,946.

FIGURE 1

Increase in PTC Amount for Households at Various Income Levels



SOURCE: Author's calculations based on the subsidy formula and using national averages for premiums.

Q: **Why does the Democrats' proposal help men more than women?**

A: The proposed PTC expansion will benefit men more than women since the U.S. median income was about $10,000 higher for men than for women ($56,264 versus $46,332) in 2020. Since men tend to make more than women and this proposal provides greater benefits as incomes increase, it almost certainly benefits men more than women overall. Some might consider this particularly unfair for older women since they have suffered the highest premium and cost-sharing increases of any group because of the ACA. In essence, the ACA hiked premiums and cost-sharing most significantly for older women, and this proposal delivers the greatest benefits to older, upper-income men.

Q: How much crowd out does CBO expect with the subsidy expansion?

A: According to CBO, about 75 percent of the new spending is on people who already have health insurance. CBO's estimates that $22.5 billion of the $35.5 billion cost of the PTC expansion would go to existing exchange enrollees. Of the remaining $13.0 billion, roughly 30 percent goes for other individuals who replace either employer coverage or other nongroup coverage with the newly subsidized coverage. So, roughly $26.5 billion of the $35.5 billion is for people who already have coverage.

Q: Why is this proposal an inefficient use of taxpayer dollars?

A: CBO estimates that the two-year cost, including some small offsets, will total about $34 billion—meaning that it would increase federal spending on PTCs by about one-third—and will increase the number of insured by only 800,000 in 2021 and 1.3 million in 2022. Therefore, on an annualized basis, this proposal boosts federal spending on the PTCs by about $17,000 for every person who is newly insured.

Q: Why does this subsidy expansion exacerbate major inequities in the tax code?

A: Premiums for ESI—both the employer share and employee share—are not subject to federal income or payroll taxes. The average tax benefit per beneficiary with ESI is about $2,000.

The proposed PTC structure means that the credit will be more valuable than the ESI tax exclusion for a much larger set of people, particularly upper-income and older households. For example, a 60-year-old worker at 200 percent of the FPL would, under the Democrats' proposal, qualify for a PTC of $10,951—more than five times the average value of the ESI tax exclusion. For a 45-year-old worker, the proposed PTC at 200 percent of the FPL is $5,575—or nearly three times the average value of the ESI exclusion. For a 30-year-old worker, the proposed PTC at 200 percent of the FPL is $4,267—more than twice the average value of the exclusion.

For a 30-year-old worker, the break-even point between the value of the PTC and the tax benefit from the exclusion is around 320 percent of the FPL. For workers who earn incomes below this threshold, the PTC exceeds the tax benefit from the exclusion. For workers who earn more than this threshold, the tax exclusion is larger than the PTC. For 45-year-old workers and 60-year-old workers, the break-even points are around 380 percent of the FPL and 830 percent of the FPL, respectively.

Q: How will employers respond to the enhanced subsidies?

A: The ACA caused a small decline in the number of smaller firms, generally those with fewer than 50 workers, offering ESI. Firms with fewer than 50 full-time employees are not subject to penalties under the employer mandate. Roughly two million people probably lost ESI because of the ACA.

Under this subsidy expansion proposal, American businesses, particularly firms with fewer than 50 workers and those with older workforces, would have large financial incentives to stop offering group health coverage. Start-up firms would have disincentives to offer group insurance.

By limiting the PTC expansion to two years, the decline in ESI may be small. CBO estimates that only about 100,000 people would lose ESI as a result of the temporary PTC expansion. Employers, even those for whom dropping coverage makes economic sense for their workers, may be reluctant to do so if they think the expanded subsidies will expire after 2022.

If the subsidies are extended beyond 2022, it will be economically rational for most firms with fewer than 50 workers to drop ESI and it will be economically rational for many firms with more than 50 workers, particularly if their workforce is older, to drop ESI. Such a subsidy expansion would lead to millions, and potentially tens of millions, of people shifting from ESI to a heavily subsidized exchange plan.

Q: Why is this subsidy expansion disastrous if made permanent?

A: The PTC structure in inherently inflationary since the tax credits limit the amount of income that people have to pay for a benchmark plan. This means that policyholders are insensitive to premium increases, giving insurers the ability to raise premiums and pass costs to taxpayers. As such, the proposed PTC expansion puts the federal budget at further risk from increased spending on health care subsidies, which would add to the already massive federal budget deficits and add pressure for tax increases and spending cuts in other parts of the budget.

Q: How will expanded subsidies affect health care prices and health insurance premiums?

A: Expanded PTCs will increase health care inflation, pushing up health care prices and premiums. Total health care spending will ratchet up, which is why the health care industry and health insurance companies enthusiastically support this proposal.

Q: Why is this proposal a violation of promises made when the ACA was enacted?

Before a joint session of Congress in 2009, then-President Obama said, “I will not sign a [health care] plan that adds one dime to our deficits—either now or in the future. I will not sign it if it adds one dime to the deficit, now or in the future, period. And to prove that I'm serious, there will be a provision in this plan that requires us to come forward with more spending cuts if the savings we promised don't materialize.” While that promise has already been broken since many of the deficit-reducing provisions in the ACA, such as the Cadillac and health insurance taxes have been repealed, Congress at least should not make the problem worse.

Q: Who is the main lobbyist organization favoring this subsidy expansion?

A: Health insurance companies are the overwhelming beneficiary of the Democratic proposal to expand ACA subsidies. Since the proposal would deliver tens of billions of more taxpayer subsidies to them annually, health insurance companies are lobbying strongly in support of this proposal. In fact, almost all of these subsidies go directly from the U.S. Treasury to health insurance companies. And expanding the number of people with PTCs means that more American consumers are insensitive to premium increases, with taxpayers picking up the cost.

Q: How will the enhanced subsidies affect work and economic output?

A: In the aggregate, CBO projects that the ACA provisions that reduce or eliminate coverage benefits as income rises would reduce work by about 2 million full-time workers and reduce gross domestic product by about 0.7 percent. This proposal decreases the marginal tax rates faced by some workers and increases the marginal tax rates faced by others.

A permanent expansion would likely lead to less work and economic output. Since this proposal increases the amount of the PTCs and since they are conditioned on having a full-time job without affordable ESI, workers have incentives to not work full-time or to choose jobs where they are not offered coverage. As the federal government assumes more responsibility for worker health care costs, this increases federal health commitments and adds significantly to government spending in the health sector.