



FISCAL FACT

April 15, 2010
No. 222

Health Care Reform: How Much Does It Redistribute Income?

by Patrick Fleenor and Gerald Prante

The health care bill passed by Congress and signed by President Obama is arguably the most significant piece of domestic policy legislation since the 1960s. The law will transform the financing of U.S. health care as government mandates coverage for individuals and becomes more involved in the pricing and terms of the policies they buy. Also, the bill expands Medicaid so that more people above the poverty line will now be eligible (up to 138 percent of poverty level).

But expanding subsidized access to health care is no free lunch. Somebody must pay for it. Because of this reality, in this *Tax Foundation Fiscal Fact*, we estimate the distributional effects of the health care reform law, the Patient Protection and Affordable Care Act.^[1] That is, we quantify the transfer of money from higher-income groups that will be used to fund benefits for lower-income and middle-income groups.

This is part of the Tax Foundation's ongoing *fiscal incidence* project that is designed to gauge the income redistribution of U.S. fiscal policies. Previously, we have used the fiscal incidence model to estimate the redistributive effects of President Obama's FY 2011 budget.^[2]

Overall, the health care bill increases the amount of income redistribution from high-income families. That is largely due to the bill's targeted Medicare tax hike on those earning more than \$200,000 (singles) and \$250,000 (couples). The Medicare tax hike would for the first time incorporate filing status into each person's Medicare tax liability, and also for the first time, the Medicare tax will not apply just to wages but also to investment income such as income from capital gains, dividends, interest and rental property. In its first year of application, 2013, the new Medicare tax will hit approximately the top-earning two percent of families. That percentage will grow as the years go by because the income thresholds are not indexed for inflation. On the other hand, we may see a repeat of the annual patch ritual that prevailed for several years for the AMT.

We estimate that the health reform law will take an additional \$52,000 on average from the families in the top one percent of the income distribution. That is on top of the redistribution in

Patrick Fleenor is Chief Economist and Gerald Prante is Senior Economist at the Tax Foundation.

fiscal year 2016 that was already expected to accrue to that family, which amounts to about \$484,000.

Though nominally part of the Medicare tax, extra tax payments will not entitle the payers to any additional Medicare benefit. In fact, Medicare benefits (on net) are being cut in the health care bill. Overall, we estimate that as a result of the health care reform, the top 1 percent would go from earning 14.7 percent of post-redistribution income to around 14.35 percent of post-redistribution income.

This income will be redistributed, not mostly to the lowest income group, but to the lower-middle income groups. The lowest income group gains little because most of the families already receive Medicaid and/or Medicare benefits. Families in those second and third deciles (10th percentile through 30th percentile) will see an average increase in their income redistribution of around \$2,000.

Middle- and upper-middle income groups (50th percentile through 90th percentile) would also be slight benefactors of the bill if not for corporate tax increases and the fees imposed on insurance companies, drug makers and medical device manufacturers. Regarding the latter, we assume that the burden of those payments will ultimately be borne by consumers of those products, who are everywhere along the income spectrum. Overall, we calculate that this extra cost would push those income groups out of the net beneficiary column and into the net payer column, though only by a small amount.

Our results are presented in the three tables below. Table 1 summarizes the average change in income redistribution from the health care bill. Table 2 provides somewhat more detail, including a tax and spending breakdown, while Table 3 shows the aggregate effects of federal fiscal policies and the health care reform on the distribution of income.

Table 1 Summary of Income Redistribution Before and After Health Care Reform Fiscal Year 2016			
Market Income Percentile	Average Income Redistribution (OMB Baseline)	Average Income Redistribution (Post-HCR)	Change in Income Redistribution
0 - 10%	+ 20,309	+ 21,236	+ 927
10 - 20%	+ 12,363	+ 14,396	+ 2,033
20 - 30%	+ 9,862	+ 11,546	+ 1,685
30 - 40%	+ 7,907	+ 8,684	+ 777
40 - 50%	+ 6,917	+ 7,172	+ 255
50 - 60%	+ 4,921	+ 4,717	- 204

60 - 70%	+187	- 248	- 435
70 - 80%	- 4,862	- 5,426	- 564
80 - 90%	- 12,131	- 12,804	- 674
90 - 95%	- 18,800	- 19,776	- 976
95 - 99%	- 61,681	- 64,852	- 3,172
99 - 100%	- 484,493	- 536,697	- 52,204
ALL	0	0	0
Exhibit:			
Top 20%	- 47,594	- 51,450	- 3,856
Top 10%	- 83,030	- 90,066	- 7,036
Top 5%	- 147,250	- 160,345	- 13,095
Top 1%	- 484,493	- 536,697	- 52,204
Main Sources: Tax Foundation Fiscal Incidence Microsimulation Model; CBO final score of health care bill; President's FY 2011 Budget			

Table 2 Distributional Impact on Average Families of Health Care Reform Fiscal Year 2016							
Market Income Percentile	Average Market Income	After Health Care Reform			Change from OMB Baseline		
		Average Tax	Average Spending	Average Income Redistribution	Average Tax	Average Spending	Average Income Redistribution
0 - 10%	6,497	2,037	23,273	21,236	158	1,085	927
10 - 20%	23,600	4,788	19,184	14,396	- 5	2,028	2,033

20 - 30%	39,887	8,309	19,855	11,546	62	1,747	1,685
30 - 40%	56,245	12,146	20,831	8,684	117	894	777
40 - 50%	75,659	16,224	23,396	7,172	112	367	255
50 - 60%	99,083	21,845	26,563	4,717	343	139	- 204
60 - 70%	125,874	28,848	28,601	- 248	529	95	- 435
70 - 80%	158,953	37,754	32,327	- 5,426	632	68	- 564
80 - 90%	210,164	51,736	38,932	- 12,804	691	18	- 674
90 - 95%	294,722	71,739	51,963	- 19,776	806	- 169	- 976
95 - 99%	517,553	141,024	76,172	- 64,852	2,243	- 928	- 3,172
99 - 100%	2,703,974	834,255	297,558	- 536,697	30,783	- 21,421	- 52,204
ALL	117,701	29,501	29,501	0	568	568	0
Exhibit:							
Top 20%	420,170	114,162	62,711	- 51,450	2,553	- 1,303	- 3,856
Top 10%	629,358	176,538	86,472	- 90,066	4,413	- 2,623	- 7,036
Top 5%	963,030	281,322	120,977	- 160,345	8,019	- 5,076	- 13,095
Top 1%	2,712,382	834,255	297,558	- 536,697	30,783	- 21,421	- 52,204

Note: Tax category above includes certain non-tax revenues.

Main Sources: Tax Foundation Fiscal Incidence Microsimulation Model; CBO final score of health care bill; President's FY 2011 Budget

Table 3
Distributional Impact on Family Income Groups (Aggregate) of Health Care Reform
Fiscal Year 2016

Market Income Percentile	Market Income (\$Millions)	Share of Income	Income After Redistribution				Aggregate Change in Redistribution from Reform (\$Millions)
			OMB Baseline		Post-HCR		
			Total Income (millions)	Share of Income	Total Income (\$Millions)	Share of Income	
0 - 10%	120,346	0.68%	495,400	2.79%	512,521	2.89%	+ 17,120
10 - 20%	435,564	2.45%	663,025	3.73%	700,421	3.94%	+ 37,396
20 - 30%	701,566	3.95%	874,481	4.92%	904,020	5.09%	+ 29,539
30 - 40%	922,421	5.19%	1,051,698	5.92%	1,064,400	5.99%	+ 12,702
40 - 50%	1,139,188	6.41%	1,243,007	7.00%	1,246,834	7.02%	+ 3,827
50 - 60%	1,319,311	7.43%	1,384,637	7.79%	1,381,927	7.78%	- 2,710
60 - 70%	1,548,150	8.71%	1,550,440	8.73%	1,545,110	8.70%	- 5,330
70 - 80%	1,887,504	10.63%	1,829,950	10.30%	1,823,272	10.26%	- 6,679
80 - 90%	2,439,072	13.73%	2,298,724	12.94%	2,290,930	12.90%	- 7,794
90 - 95%	1,711,423	9.63%	1,602,589	9.02%	1,596,940	8.99%	- 5,649
95 - 99%	2,397,485	13.50%	2,112,645	11.89%	2,097,999	11.81%	- 14,646
99 - 100%	3,178,191	17.89%	2,610,494	14.70%	2,549,325	14.35%	- 61,169
ALL	17,764,327	100.00%	17,764,327	100.00%	17,764,327	100.00%	0
Exhibit:							
Top 20%	9,726,171	54.75%	8,624,452	48.55%	8,535,194	48.05%	- 89,258
Top 10%	7,287,099	41.02%	6,325,728	35.61%	6,244,264	35.15%	- 81,464

Top 5%	5,575,676	31.39%	4,723,139	26.59%	4,647,324	26.16%	- 75,815
Top 1%	3,178,191	17.89%	2,610,494	14.70%	2,549,325	14.35%	- 61,169
Main Sources: Tax Foundation Fiscal Incidence Microsimulation Model; CBO final score of health care bill; President's FY 2011 Budget							

Overview of Methodology

To quantify how much the new health bill changes income redistribution in the future, we must first calculate the extent of redistribution that would have occurred without the bill. That is the "baseline scenario," and we base that analysis on what the laws would have been in 2016 according to the Office of Management and Budget (OMB baseline). We then compare that with the "policy scenario," which is the OMB baseline supplemented with the provisions of the newly enacted health reform. We can then answer the question, "How much does the health care bill redistribute income?"

Our measure of income redistribution is relatively simple as we ask two hypothetical questions:

- (1) How much in federal taxes does a given income group pay under a given set of tax policies?
- (2) How much in federal taxes would that income group pay under a benefit principle system of taxation whereby a given family's tax share was equal to its share of the benefits from government spending?

The difference between the answers to these two questions is our measure of income redistribution. Two common questions pertaining to the methodology are:

How can defense spending be split up among various income groups?

What about the deficit: if the government uses borrowing instead of taxing to spend money on behalf of one income group, who is determined to have paid?

Those difficult questions are decided in advance with economic assumptions. That is, in analyzing defense spending, we do not examine each component of defense spending. Whether a military base is in a poor area or a rich one, we count it as part of a massive national effort to protect the whole country. To divide up that spending among the people, we do not assign an equal amount to each family; rather we divide it up in proportion to each family's share of cash income received. That is our proxy for a family's "willingness to pay" for national defense. (In technical terms, we assume an income elasticity of national defense and most other public goods that is unitary, or equal to -1.)

As for the deficit, we assume that the burden of paying for the deficit is borne by today's families and is financed by a combination of proportional tax increases and proportional spending reductions (entitlements weighted more heavily). For a further discussion of the methods used in this report, see *Tax Foundation Special Report*, No. 172, "How Much Does President Obama's Budget Redistribute Income?"^[3]

The cuts to Medicare and Medicaid providers in the health bill were assumed to be borne partly by Medicare enrollees and partly by owners of capital. Fees imposed on insurance companies, medical device manufacturers and drug companies were assumed to be borne by consumers of

those products. The distributions of the changes to coverage, including the exchange subsidies, and changes in Medicare tax liability were simulated using a tax and spending microsimulation model.

An important point to keep in mind is that our fiscal incidence model is just that: *fiscal*. It does not measure the distributive effects of government policies outside of taxing and spending. For example, minimum wage laws redistribute income, but we do not include such "redistribution" in our analysis. This is an important limitation when analyzing health care reform because the new law includes many regulations. Mostly, they are imposed on insurers and will implicitly redistribute resources. In general, they will redistribute income from healthy people to sick people; that is, healthy people will pay more for policies so that sick people can pay less. But this transfer is not included in our analysis.

Notes

[1] This analysis includes the "fixes" passed by the House and Senate and signed by President Obama after the signing of the original Patient Protection and Affordable Care Act, also known as the Senate bill.

[2] Prante and Fleenor, *Tax Foundation Special Report*, No. 172, "How Much Does President Obama's Budget Redistribute Income?" Tax Foundation, September 2009. See www.taxfoundation.org/publications/show/25200.html.

[3] See <http://www.taxfoundation.org/publications/show/25200.html>.