Heads Up:
A Tax on Employee Benefits Is Coming Your Way

Inforum Report to the
National Association of Manufacturers

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Introduction and Conclusions

Manufacturers and other employers take their mission to provide health care benefits to their employees seriously. They understand that high quality health benefits are vital to attract and retain the best workers, and they also know that keeping employees and their families healthy and happy, which hopefully boosts the productivity of their work. Moreover, employers have found that benefit packages are greatly enhanced by more than just medical insurance, but by other vehicles such as worksite clinics, employee assistance programs, and wellness programs.

Governments are also active players in health care markets. In particular, private insurance markets require government oversight, and medical care for citizens is heavily subsidized by both federal and state governments. The Patient Protection and Affordable Care Act (ACA) made many changes to the existing system in order to achieve the goal of extending insurance coverage to the previously uninsured. These changes included mandatory alterations to rules governing employer-provided insurance. In particular, the ACA imposes a 40 percent excise tax on health insurers and health plan administrators for the value of coverage exceeding specific thresholds beginning in 2018. This tax penalty on so-called high-value plans (also referred to as the "Cadillac tax") is intended to indirectly limit the tax exclusion for employer provided health insurance coverage.

However, because the costs of health care insurance premiums, products, and services usually outpace general price and income growth, over time the tax will start to capture benefit structures most would categorize as typical or average. Moreover, options to avoid the tax by further increasing deductibles and other cost sharing arrangements and then adjusting compensation levels to offset these new costs might be difficult to achieve in practice, especially because efforts to reduce premiums to avoid the tax could be constrained by ACA's minimum benefit levels value requirements, out-of-pocket limits, and essential health benefit standards.

In addition, premiums are only part of the taxable value of a benefits package; the law also contemplates the taxation of other benefit components including on-site medical clinics, on-site pharmacies, wellness programs, employee assistance programs, flexible spending accounts, and health savings accounts.[1] These complexities and their potential problems explain why a full three years beforehand, firms and employees are forced to consider the tax when examining the overall structure of current benefit packages. Indeed, the health benefit plans of tomorrow will have to be evaluated for how the excise tax might be triggered in both the short and long term.

[1] Internal Revenue Service, see IRS Circular 4980I(d) (1)(A) through (D).

This report examines the Cadillac tax with a two-stage process as indicated by Box A. First, we use historical (2014) data on the levels and distributions of employer premiums to estimate the industry-level incidence of the tax under three scenarios for the growth of health care premiums. Though they could also be taxed (See Box A), other components of health packages such as work-site health clinics and tax-preferred savings accounts are highly variable depending on the employer's strategy. Since data limitations prevent a precise measure of the future value of these benefits, the additional tax is not included in the following analysis. To the extent that taxable items are not captured, the adverse cost and economic impacts shown here will be understated.

The "medium" premium-only growth scenario assumes that health insurance premiums grow by 6.0 percent annually. The low-growth premium case assumes that premiums grow by 4.0 percent per year, while the high premium growth scenario assumes growth of 8.0 percent per year. The analysis quantifies the pace and burden of the tax for major industries across time by computing the growth in the tax thresholds using assumptions for long-term general price inflation and the three scenarios for health insurance premium growth.

Beginning in 2018, the tax will apply to the cost of benefits above $10,200 for plans covering single employees and benefits above $27,500 in family plans. While it was designed to hit so-called "high-value" plans, the excise tax will quickly spread to many "middle class" plans because increases in the tax thresholds are based on the consumer price index (CPI) even though the growth in health care expenditures, and therefore premium costs, have historically outpaced general inflation. Over time, a very high proportion of premium levels cross the thresholds, subjecting more and more plans to the tax. For instance, in the medium premium growth scenario, 29 percent of all employees' health plans will be taxed by 2025 when calculating based on premium growth alone. By 2035, that proportion rises to 82 percent. In the high growth scenario, the proportion of plans taxed in the manufacturing sector is 60 percent by 2025 and 97 percent by 2035 based on calculations using just premiums.

Part two of the analysis uses the Inforum LIFT interindustry macroeconomic model to estimate the industrial and macroeconomic impacts of the employee benefits tax for each of the three scenarios described above. The LIFT model is well-suited for the task because it contains price functions by industry and an interindustry structure, which shows how higher labor costs in one sector can cascade through the economy, reducing competitiveness and income across the economy.[2] The tax projections were inputted into the LIFT model and the simulation results were compared to a baseline of the model without the tax. Under each scenario, real GDP, exports, consumption, investment, and exports are all reduced proportionately to the size of the tax increases. National results are provided as differences from the baseline for industry variables such as output, trade, and employment; and for macroeconomic variables such as GDP, disposable income, and total employment. The projection horizon is 2015 to 2035.

[2] LIFT stands for Long-Term Interindustry Forecasting Tool. LIFT is developed and maintained at the Inforum Research Center at the University of Maryland, College Park. For further information see: www.inforum.umd.edu.

Box A: Outline of Health Benefits Tax Study

Stages of Modeling

1. Estimate Impact of Tax on Employers Overall and By Major Industry Group
    a. Extrapolate 2014 Kaiser Family Foundation (KFF) premiums by major industry forward to 2035 using alternative premium growth scenarios and compare with tax thresholds as projected by the Congressional Budget Office (CBO).
    b. Compute the percentage of employees affected by the tax by industry.
    c. Compute amount of tax paid for each industry assuming no tax avoidance via lower benefits.

2. Compute the Macroeconomic and Industrial Impact by Industry
    a. Use Bureau of Economic Analysis (BEA) data on overall benefits to break out major industry results.
    b. Impose the tax as an increase cost of labor by detailed industry sector in LIFT.
    c. Run 3 simulations using alternative labor cost scenarios and compare results to the baseline assuming no tax.

Since the tax thresholds rise with general inflation that is much lower than the actual rise of health care premiums, the tax burden rises exponentially. In the medium growth case, real GDP is reduced by $33.3 billion (2014 dollars) by 2025 and $165.6 in 2035. If premiums grow at 8.0 percent, the loss of real GDP is $88.9 billion (again in 2014 dollars) and over $476 billion by 2035. In this high premium growth case, the decrease in real GDP is felt almost immediately and it exceeds 1.6 percent by 2035.

As the benefits tax ultimately falls on labor, employment is reduced and real household income is disproportionately impacted. Employment losses reach 129,000 jobs in 2035 under the low growth case, 917,000 in the medium growth scenario, and 2,629,000 in the high premium growth case. In the high growth case, real personal income in 2014 dollars is reduced by over $700 per household in 2025 and over $3,700 per household 2035.

Background

The Affordable Care Act (ACA) includes a 40 percent excise tax on the value of employer-provided health benefits above specified cost thresholds, effective in 2018. The tax applies to the whole premium for coverage, regardless of the share paid by employees. For fully insured coverage, where the employer purchases insurance from a health plan, the tax applies to the premiums paid. For self-funded plans (where the employer is at risk for health benefits costs) the taxable premium is based on the amount that is charged for continuing post-employment (COBRA) coverage.

Health insurance subject to the 40 percent excise tax in the ACA will also include premiums paid by the employee and the employer for dental and vision coverage if this supplemental coverage is not part of a stand-alone package. The taxable benefits will include health savings account (HSA) and health reimbursement account (HRA) contributions, as well as flexible savings account (FSA) contributions by employers.[3] Depending on the pending regulations on the administration of the tax, it might also cover employers' costs for employee assistance programs (EAPs) and costs associated with on-site worksite health clinics (WHC). Box B contains a discussion of the value and potential taxability of WHCs.

In 2018, thresholds for the excise tax will be $10,200 for single coverage and $27,500 for family coverage. Premiums and other benefits above the thresholds are taxed at 40 percent on the amount above the threshold. Adjustments of $1,650 for single and $3,450 for family (to $11,850 and $30,950, respectively) would be made for certain firms with pre-Medicare retirees or a majority of workers in high-risk jobs.

The thresholds are indexed by growth in the consumer price index (CPI) plus one percentage point in 2019 and 2020 and then by CPI growth thereafter. Over history, health insurance premium growth has typically outpaced this measure of general inflation. Assuming that this trend continues into the future, over time a growing proportion of health care plans will cross the tax thresholds and will then be taxed simply due to the erosion of the threshold established by law relative to overall health care inflation.

[3] Health Policy Brief: Excise Tax on 'Cadillac' Plans, *Health Affairs*, September 12, 2013.(online December 3, 2009; 10.1377/hlthaff.2008.0430) http://healthaffairs.org/healthpolicybriefs/brief_pdfs/healthpolicybrief_99.pdf

Box B: Worksite Health Clinics and the Employee Benefits Tax

The tax status of Worksite Health Centers (WHCs), an important component of employee health benefits, remains uncertain: many employers, especially manufacturers, have found that investments in WHCs produce great returns on employee productivity and job satisfaction. They enhance employee health and reduce the cost of care by focusing on wellness and prevention and by providing accessible and low cost primary services, especially in areas where primary care facilities are in short supply.

Worksite health expenditures have climbed rapidly over time, reaching over $5 billion in 2013, from just half of that 20 years earlier. While spending flattened during the recession, it has revived strongly, testifying to the commitment that employers have to WHCs.

Unfortunately, investments in most WHCs could fall under the health benefits tax if current IRS proposals are ultimately adopted. Under IRS code, the costs for WHCs that exceed the "de minimus" services (i.e., services exceeding a mere first aid station) are to be incorporated into a firms' COBRA premium, which is the premium used in the ACA for charging the excise tax.[4] Precisely because they are such a valuable and low-cost provider of primary health care, most WHCs today have provide services well-exceeding the de minimus status, and they will therefore be subject to the excise tax. If this interpretation stands, employers will face a rising tax bill for their clinics that could ultimately reach 40 percent of their expenses. Long before this rate is reached, however, most clinics would probably become prohibitively expensive and employers will lose a vital and innovative tool that is doing much to enhance the health of Americans at a very low cost.

CBO/JCT Analysis of the Health Benefits Excise Tax

The latest CBO estimate is that the employer benefits excise tax will raise approximately $90 billion over the 2018-2025 period (cumulatively). In their assessments of the health care benefits excise tax, the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) assume that many employers will avoid the tax by simultaneously reducing the generosity of their health insurance coverage while increasing taxable wages to compensate for the reductions.[5] In that case, instead of paying a 40 percent tax, employees would pay taxes on wages and salaries instead, often at about a 15 percent rate for income tax and a 15 percent rate (employer plus employee) for payroll taxes. Employees with higher incomes would pay a higher income tax rate, although at very high incomes – currently defined as above $118,500 – employees do not pay additional payroll taxes, so their effective payroll rates are reduced.

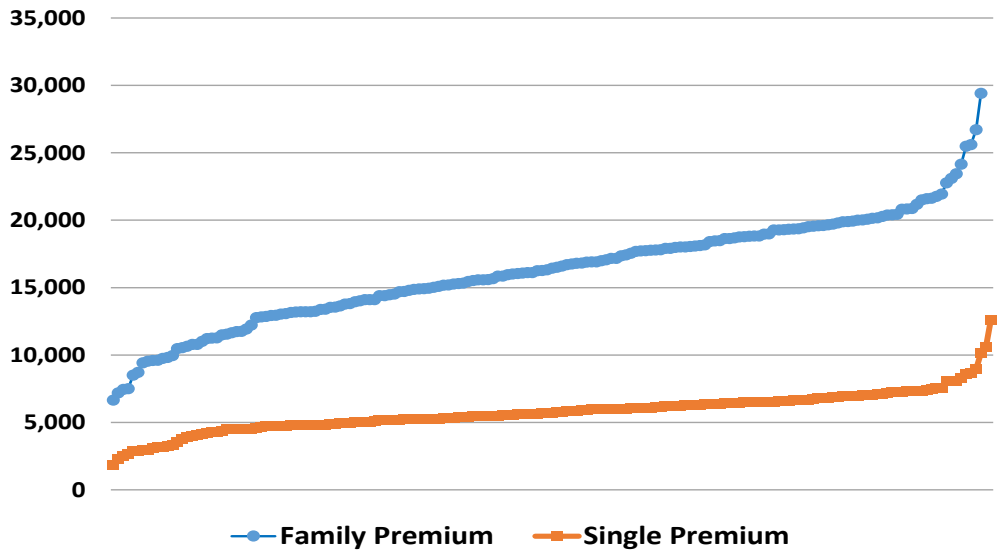
4 National Association of Worksite Health Centers, Response to IRS Notice 2015-16 (Excise Tax on High Cost Employer Sponsored Health Coverage) http://www.worksitehealth.org/sites/www.worksitehealth.org/files/assets/FINAL%20-%20NAWHC%20Response%20to%20Excise%20Tax%20Notice%205-15-15.pdf

5 Congressional Budget Office (CBO), The 2015 Long-Term Budget Outlook, www.cbo.gov/publication/50250.

Employer Insurance Characteristics 2014

For this project, we used data from the 2014 KFF survey to assess employer premiums within major industry groups. For 2014, the survey included detailed information on premiums, enrollment patterns and benefits for over 1,800 employers. Figure 1 plots the distribution of single and family plan premiums of responding manufacturing companies from the KFF survey. It illustrates plan premiums ranked from the lowest on the left to the highest on the right. The level of single premiums is shown by the bottom line and family premiums by the upper line. The pattern of family premiums appears fairly similar to that of single premiums. Interestingly, however, the rankings of family and single premiums in Figure 1 are not necessarily aligned for each company; that is, some companies may have single premiums that are ranked lower than their family premiums, and vice versa.

Figure 1: Surveyed Manufacturing Sector Premiums, Single and Family, Ranked from Lowest to Highest, 2014



Source: KFF/HRET 2014 Employer Benefits Survey, calculations by INFORUM.

Why do premiums range so widely? The main factors are the healthcare claims costs of the workers themselves. For large employers, premiums are based on average or expected health costs for the entire company group, which is the pool of workers at the company who participate in health benefits. Premiums can be quite different from company to company based on the health needs of their workers, even among companies in the same region or with a similar demographic profile of employees. Very large employers may have a sufficient number of workers that their health costs will be very predictable; smaller employers, even those with as many as 500 employees, may see employees' costs swing widely from year to year. There are rules for small employer plans designed to help prevent the widest swings in premiums, but these offer only partial relief from an unpredictable market place.

Health Care Premiums and the Employee Benefits Tax by Industry, 2018-2035

As the first step in assessing the possible effects of the new tax, we developed a projection model of premiums and the associated excise tax based on detailed data from the Kaiser Family foundation (KFF) annual survey of employer health benefits. Except as noted, all calculations from the KFF survey data are performed by Inforum using the 2014 public use research files. Thus, any errors in the following calculations should be attributed to the authors, not to KFF.

The model is based on single coverage premiums and the single premium thresholds. Abstracting away from family coverage and computing premiums as single basis rather than a per-employee basis (single and family) makes the model simpler and easier to use. We believe that modeling single coverage is an excellent proxy for the overall impact of the tax, and our estimates correspond closely to those of CBO under reasonable assumptions about the growth of health costs.

Finally, as mentioned earlier, taxable benefits will include health savings account (HSA) and health reimbursement account (HRA) contributions, as well as flexible savings account (FSA) contributions by employees and employers.[6] Depending on the pending regulations on the administration of the tax, it might also cover employers' costs for employee assistance programs (EAPs) and costs associated with on-site worksite health clinics (WHC) and other benefits. Since data limitations prevent a precise measure of the future value of these benefits, the additional tax is not included in the following analysis. To the extent that taxable items are not captured, the adverse cost and economic impacts shown here will be understated.

The KFF 2014 premium distributions were projected into the future under three different scenarios for growth in premiums:[7]

1. Low Premium Growth (4.0 percent annually)
2. Medium Premium Growth (6.0 percent annually)
3. High Premium Growth (8.0 percent annually)

None of these premium scenarios is particularly unlikely or extreme. Table 1 shows that according to the KFF survey, from 1999 to 2015, premiums for employer plans grew 6.8 and 7.2 percent for single and family coverage, respectively. At the same time, the CPI inflation index grew by an average of 2.3 percent over the period. Moreover, recent history can be split between two intervals. From 1999 through 2007, average single premiums rose by a 9.4 percent per year and family premiums grew by an even greater 9.7 percent per year. On the other hand, since 2008 premium growth has averaged just 4.3 and 4.8 percent, the slowest multi-year pace since records were first kept over 50 years ago.

[6] Health Policy Brief: Excise Tax on 'Cadillac' Plans, *Health Affairs*, September 12, 2013. (online December 3, 2009; 10.1377/hlthaff.2008.0430) http://healthaffairs.org/healthpolicybriefs/brief_pdfs/healthpolicybrief_99.pdf

[7] All scenario projections reflect the recently released overall 2015 premium levels from the 2015 KFF employer health benefit survey, which showed an increase of about 4 percent. Thus the scenario projections begin in 2016.

Table 1: Growth of the Consumer Price Index versus the Growth of Premiums
Average Annual Rate of Growth, 1999-2035

	History			Medium Projection
	1999-2015	1999-2007	2007-2015	2015-2035
Consumer Price Index	2.3	2.8	1.9	2.4
Single Premiums	6.8	9.4	4.3	6.0
Difference	4.5	6.6	2.4	3.6
Family Premiums	7.2	9.7	4.8	6.0
Difference	4.9	6.9	2.9	3.6
GDP	4.0	5.2	2.6	4.5

Source: KFF/HRET 2015 Employer Benefits Survey and Bureau of Labor Statistics

Some of this recent drop in growth can be attributed to the decline in general inflation, about 1 percent according to the change in CPI inflation. The rest of the slowdown is due to several factors, including the deep recession starting in 2008, reductions in benefits levels (higher deductibles and copayments as discussed above), and new incentives for health care providers to provide care more efficiently (mostly via Medicare payments to hospitals). Some of these factors, particularly the recession, are very likely temporary reprieves from overall trends.

In their projections for insurance premiums going forward, both the CBO and the Center for Medicare and Medicaid Services (CMS) project that premiums will accelerate as the economy recovers fully from recession. Our "medium" premium scenario assumes premium growth of 6.0 percent per year from 2016, a pace that is one percent lower than average since 1999. Premium growth in the first eight years of the century were much larger, however, averaging between 9 and 10 percent, so it is also important to evaluate the effects of the employee benefit tax assuming faster premium growth. As explained below, the impacts rise exponentially with premiums so even small adjustments can change the outcomes significantly. In particular, our "high" premium scenario assumes 8.0 percent growth per year. Finally, we developed a "low" alternative assuming just 4.0 premium growth, which could be considered as a floor, even if recent growth rates persist.

Impact on Manufacturing Workers

Figures 2 and 3 illustrate how the tax would gradually affect companies in the manufacturing sector over time, for single and family premiums, respectively, under the medium premium growth scenario. In these figures, companies are ranked from the lowest premiums on the left to the highest on the right. Premium lines for 2018, 2025, and 2035 are shown assuming that each premium grows by 6.0 percent per year from 2015. Initially, in 2018, only a small proportion of insurance plans exceed the threshold (color-coordinated horizontal line).

According to the latest CBO projections the CPI is to average growth of 2.4 percent per year, so the excise tax threshold will rise at the same rate.[8] Because of this differential growth, more and more of the premium curve crosses the threshold line over time, meaning that a higher and higher proportion of plans are hit with the tax.

Figure 2. Premiums and Tax Thresholds for Single Coverage, Manufacturing Medium Premium Growth Scenario

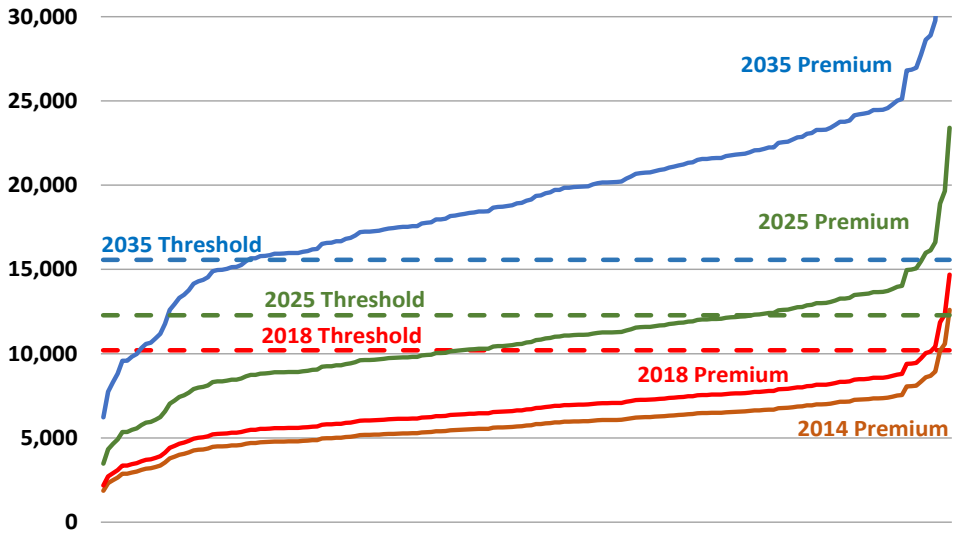
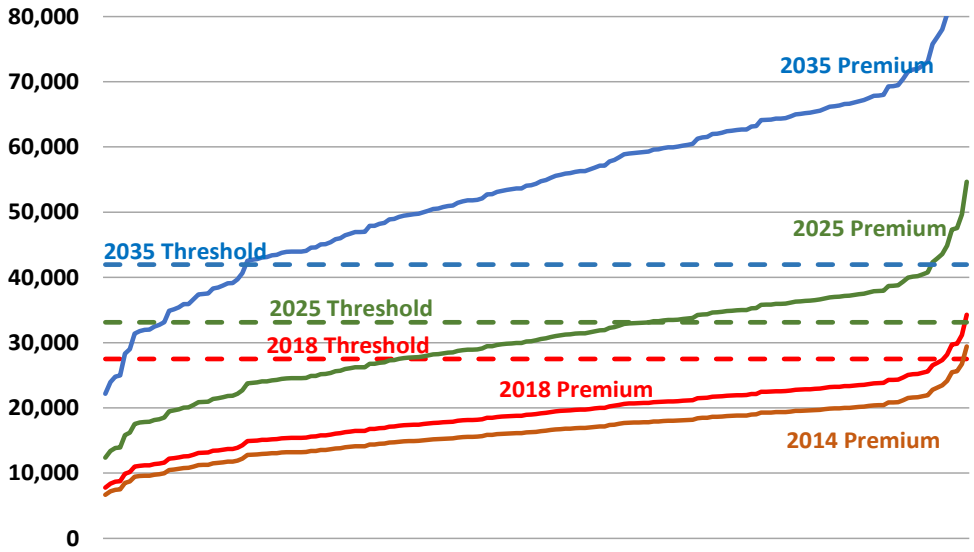


Figure 3. Premiums and Tax Thresholds for Family Coverage, Manufacturing Medium Premium Growth Scenario



[8] Congressional Budget Office (CBO), The Budget and Economic Outlook: 2015 to 2025, https://www.cbo.gov/publication/49892

Figure 4 shows how this dynamic works to boost the percentage of employees in the manufacturing industry affected by the tax under each scenario. In the medium premium growth scenario, 28 percent of health plans will be subject to the tax by 2025. By 2035, that proportion rises to 83 percent. In the high premium growth scenario, the proportion of plans subject to the tax in the manufacturing sector exceeds 60 percent by 2025 and 90 percent by 2035. Again, these calculations are based on just the average premiums, not the full complement of benefits that would be subject to the tax threshold as currently constructed under the law.

Figure 4. Percent of Employees Affected, Manufacturing
Low (4%), Medium (6%), and High (8%) Premium Growth Scenarios

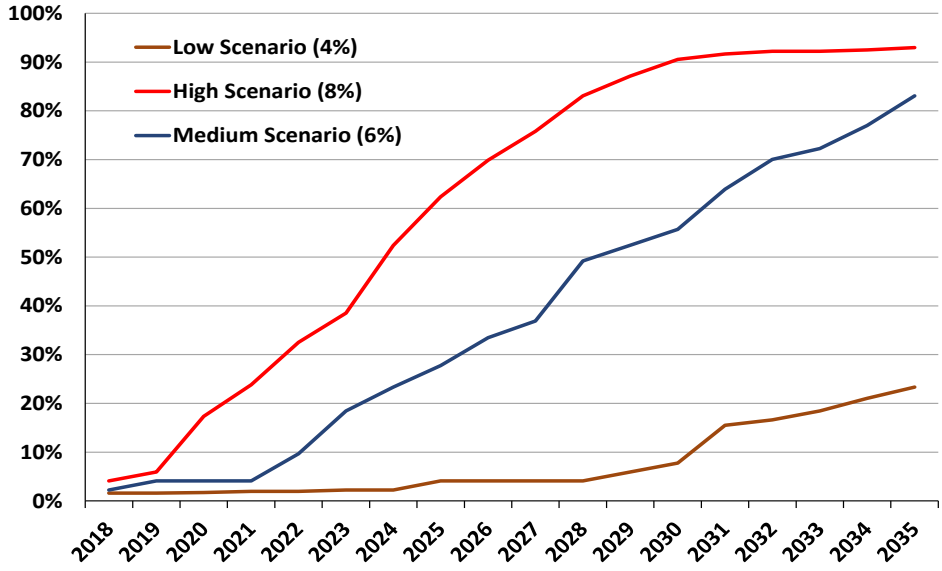


Table 2 shows how the economy-wide average single and family premiums compare to the tax thresholds for each of the three premium growth scenarios: low (4%), medium (6%), and high (8%). The tax thresholds grow by only 2.4 percent per year. Thus, even in the lowest premium growth scenario the average premiums will gradually catch up to and then exceed the thresholds over time. Under the medium scenario average single premiums are almost $15,000 by 2030, exceeding the threshold of $13,824. Similarly, the average family premium exceeds the threshold by 2030. Thus, over half of workers would be affected by the excise tax by then.

The proportion of workers over time and for each scenario is shown in the third set of figures on Table 2. Under the high growth scenario more than half would be affected by the tax by 2025 and almost 93 percent by 2035.

Table 2: Excise Tax Threshold, Average Single Premiums, Proportion of Workers Affected, and Tax Collections under Alternative Scenarios

	2014	2018	2020	2025	2030	2035
All Industries						
Basic Thresholds (CPI from CBO Long Term Projections, June 2015)						
Single		10,200	10,905	12,278	13,824	15,565
Family		27,500	29,402	33,103	37,271	41,964
Average Single Premium (dollars)						
Low Premium Growth (4%)	6,025	7,031	7,605	9,253	11,258	13,697
Medium Premium Growth (6%)		7,445	8,365	11,194	14,981	20,048
High Premium Growth (8%)		7,874	9,185	13,495	19,829	29,135
Average Family Premium (dollars)						
Low Premium Growth (4%)	16,834	19,646	21,249	25,853	31,454	38,269
Medium Premium Growth (6%)		20,801	23,372	31,278	41,857	56,014
High Premium Growth (8%)		22,001	25,662	37,706	55,403	81,405
Proportion of Workers Affected (percent)						
Low Premium Growth (4%)		5%	5%	10%	17%	25%
Medium Premium Growth (6%)		8%	12%	29%	57%	82%
High Premium Growth (8%)		12%	21%	60%	88%	97%

Excise Tax Incidence by Industry

Table 3 details the tax impact of the employee benefits tax for the major industries over time and for each scenario. If premiums grow by 4.0 percent, then tax revenue will grow slowly from $7.6 billion by 2025 to $35.7 billion by 2035. For medium growth, the tax increases to $31.8 billion in 2025 and $243.6 billion by 2035. If premiums grow by an average of 8 percent per year, revenue collections accelerate to $672.9 billion by 2035 – almost 1.5 percent of GDP!

For manufacturing, the tax impact rises from $0.2 billion in 2018 to $16.1 billion in 2035 under the medium growth scenario. Collections reach $46.8 billion in 2035 under the high growth scenario. The biggest tax payers are health care (suggesting that the excise tax might set off a bit of a vicious circle in medical care prices), the very large private services sector, and to a large extent, government. Tax estimates with more sectors, including detail for manufacturing industries, is shown in the Appendix.

These figures assume that there are no changes in behavior intended to shift the burden of the tax onto workers, and thus the employer pays the entire tax. In reality, some employers may be able to increase cost-sharing further to fend off the tax for several years. This would be feasible particularly if health costs took the low premium growth scenario. In the long run, however, even in a low premium growth environment most companies would have to contend with the tax in some fashion. As noted above, if greater cost sharing is offset with taxable wage increases, then the overall tax burden might be reduced, but only marginally. Nevertheless, the assumption that roughly the same amount of revenue is collected either directly through the excise tax or indirectly through increases in payroll and income taxes probably overstates the revenue collection.

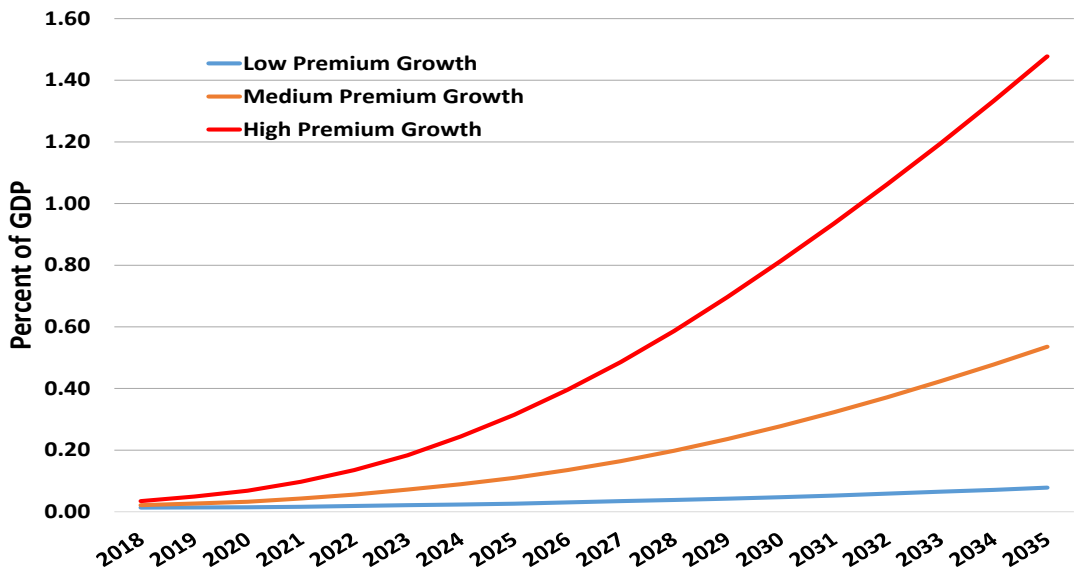
On the other hand, these figures are based on taxes paid only on premiums exceeding the threshold, not other benefits that will be taxed such as health savings account (HSA), health reimbursement account (HRA) contributions, as well as flexible savings account (FSA) contributions, employers' costs for employee assistance programs (EAPs), and costs associated with on-site workplace medical clinics. The tax take demonstrated by Table 3 is underestimated to the extent that such programs expand.

Figure 5 shows the three trajectories of the total tax as a percent of GDP. The important point to note is that given that the tax threshold is indexed to CPI and not health care cost growth, the Cadillac tax's share on the nation's income accelerates through time.

Table 3: Total and Industry Incidence of Employee Benefits Tax

Billions of Dollars	Premium Growth	2018	2020	2025	2030	2035
Total Employee Benefits Tax	Low	2.8	3.4	7.6	17.2	35.7
	Medium	4.5	7.6	31.8	100.6	243.6
	High	7.3	15.7	90.8	294.7	672.9
as percent of GDP	Low	0.01	0.01	0.03	0.05	0.08
	Medium	0.02	0.03	0.11	0.28	0.54
	High	0.03	0.07	0.31	0.81	1.48
Agric, Mining, Construction	Low	0.2	0.2	0.4	0.8	1.7
	Medium	0.2	0.4	1.4	4.2	10.5
	High	0.3	0.7	3.9	12.8	29.8
Manufacturing	Low	0.2	0.2	0.3	0.6	1.5
	Medium	0.2	0.3	1.6	6.3	16.1
	High	0.3	0.7	6.2	21.2	46.8
Transport, Utilities, Communications	Low	0.2	0.3	0.6	1.5	3.0
	Medium	0.4	0.7	3.0	7.8	16.8
	High	0.7	1.5	7.3	20.8	44.7
Wholesale Trade	Low	0.0	0.0	0.0	0.2	0.6
	Medium	0.0	0.0	0.7	2.3	6.1
	High	0.0	0.2	2.1	8.2	21.5
Retail Trade	Low	0.0	0.0	0.1	0.3	0.7
	Medium	0.1	0.1	0.8	4.3	12.7
	High	0.1	0.3	4.3	18.1	47.2
Finance, insurance, real estate	Low	0.3	0.4	0.8	1.6	2.7
	Medium	0.5	0.7	2.3	6.5	16.5
	High	0.7	1.4	5.9	20.4	45.9
Health	Low	0.6	0.8	1.7	3.8	8.7
	Medium	1.0	1.5	7.0	24.3	59.1
	High	1.5	3.2	20.3	65.5	150.7
Other Private Services	Low	1.0	1.3	3.3	7.2	14.3
	Medium	1.8	3.2	12.6	37.5	88.8
	High	3.0	6.5	34.0	106.6	242.2
Government	Low	0.2	0.2	0.5	1.2	2.5
	Medium	0.3	0.6	2.4	7.4	16.9
	High	0.6	1.3	6.9	21.0	44.1

Figure 5: Employee Benefits Tax as a Percent of GDP



Macroeconomic Effects

We employed the LIFT model of the U.S. economy to compute the industry-level and macroeconomic impacts of the employee benefits tax for the three scenarios developed in the previous section. The LIFT model is an annual dynamic interindustry macroeconomic tool that provides a general equilibrium (economy-wide) framework with a "bottom-up" accounting of the U.S. economy. It contains a detailed industry (input and output) supply and demand structure embedded in the macroeconomic framework of the National Income and Product Accounts.

The LIFT model is well-suited for the task at hand because it contains price functions by industry and an interindustry (input–output) structure, which shows how higher labor costs in one sector can cascade through the economy, reducing competitiveness and income. The methodology was to add the employee benefit taxes into the labor cost included in the model's industry price functions, solve the equations of the model with the additional costs included in the calculations, and then compare the simulation to a baseline scenario that assumes no employee benefits tax. The model computes the impact on costs and competitiveness per sector, individual industries, and the economy as a whole.

The model assigns tax increases across the industries of the LIFT model using the incidence as computed above using the KFF data for the major sectors such as manufacturing, health services, and finance. Since LIFT has a more detailed industry configuration than the KFF data (e.g., subsectors of manufacturing), the employee benefits tax was allocated to detailed sectors using the model's shares of all employee benefits for each sub-industry.

The new taxes enter the industry cost functions and directly raise commodity prices in the year of the incidence. As firms increase their prices, demand for their products slow, and the firms are more vulnerable to foreign competition. Some prices increase by more than others, so

relative prices across products change as well. A full assessment of the effects requires recognition of the linkages among the industries that comprise the economy. One industry's revenues are another industry's costs. In this case, downstream producers will eventually respond by increasing their prices, further reducing output, net exports, and employment. Ultimately, the cost of the taxes ends up in the final consumption basket or in the trade deficit.

Table 5 shows the results of running the model scenarios. Figures on the table are differences of the indicator compared to a baseline scenario that assumes no benefit tax. Results for most variables are expressed in the percent difference, but in some cases the differences are shown in dollars or jobs.

Real GDP, consumption, investment, and exports are all reduced modestly and proportionately to the size of the tax increases. Figure 6 displays the impact on GDP in percentage terms, and it clearly shows the exponential impact of the tax. In the low premium growth case, the decrease in real GDP never exceeds 0.01 percent, but in the high growth case it eventually exceeds 1.6 percent.

Employment is similarly affected. Losses peak in 2035 at 129,000 jobs in the low growth case, 917,000 in the medium growth scenario, and 2,629,000 in the high premium growth case. Because the tax ultimately falls on labor, real household income is disproportionately impacted. In the high growth case, it falls by 2.14 percent in 2035, in contrast to a real GDP loss of just 1.65 percent. This is equivalent to almost $3,758 per household in 2014 dollars. The macroeconomic modeling results illustrate how the employment benefits tax could produce large and unintended damage if premiums rise at the rate seen earlier in the century.

Figure 6: Reduction of GDP due to Employee Benefits Tax

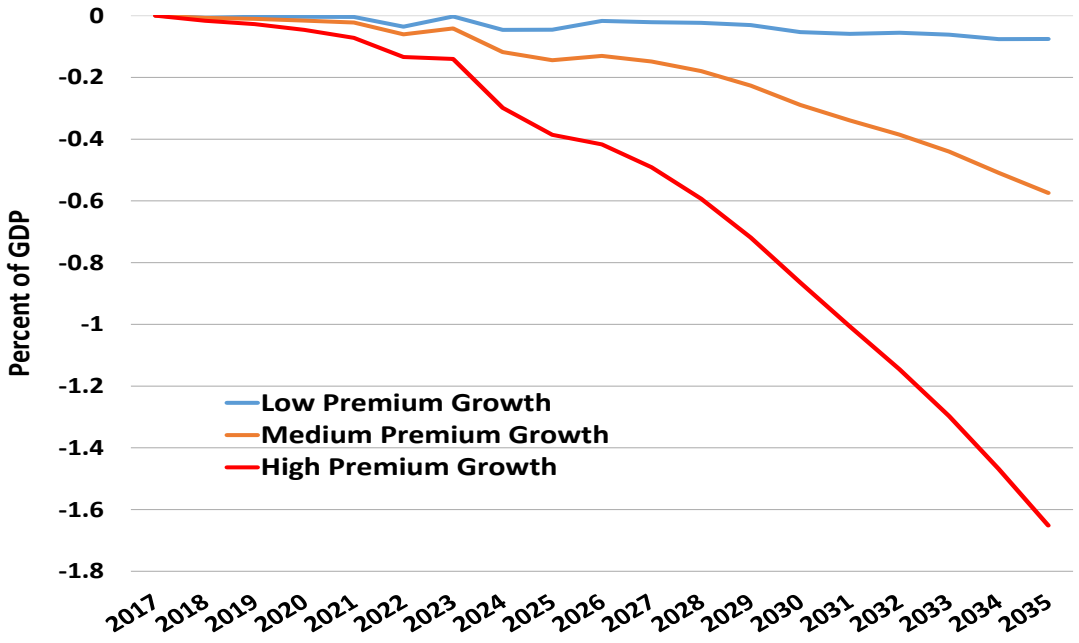


Table 5: Macroeconomic Effects of Employee Benefits Tax
All figures are difference from no tax baseline scenario as indicated

	Premium Growth	2018	2020	2025	2030	2035
REAL GDP by FINAL DEMAND CATEGORY						
Real Gross Domestic Product						
Difference in billions	Low	-1.3	-0.7	-10.4	-13.7	-21.8
2014 dollars	Medium	-1.4	-3.3	-33.3	-74.5	-165.6
	High	-3.2	-9.4	-88.9	-222.7	-476.2
Percent difference	Low	-0.01	0.00	-0.05	-0.05	-0.08
	Medium	-0.01	-0.02	-0.14	-0.29	-0.57
	High	-0.02	-0.05	-0.39	-0.86	-1.65
Personal Consumption	Low	0.00	0.00	-0.06	-0.05	-0.08
Percent difference	Medium	0.00	-0.01	-0.16	-0.28	-0.53
	High	-0.01	-0.03	-0.40	-0.84	-1.52
Gross private investment	Low	-0.04	-0.02	-0.07	-0.08	-0.10
Percent difference	Medium	-0.03	-0.04	-0.22	-0.39	-0.74
	High	-0.05	-0.09	-0.57	-1.14	-2.08
Exports	Low	0.00	-0.02	-0.02	-0.06	-0.10
Percent difference	Medium	-0.01	-0.05	-0.11	-0.35	-0.86
	High	-0.02	-0.09	-0.36	-1.06	-2.47
PRICE INDICATORS						
GDP Deflator	Low	0.01	0.01	0.03	0.06	0.10
Percent difference	Medium	0.02	0.03	0.13	0.34	0.67
	High	0.03	0.07	0.37	0.98	1.88
PCE Deflator	Low	0.01	0.01	0.03	0.04	0.06
Percent difference	Medium	0.01	0.02	0.09	0.21	0.41
	High	0.02	0.05	0.25	0.63	1.18
EMPLOYMENT AND INCOME						
Total Employment	Low	-6	-5	-80	-75	-129
Thousands of jobs	Medium	-7	-21	-225	-436	-917
	High	-16	-60	-582	-1325	-2629
Real Household Income	Low	-0.02	-0.02	-0.06	-0.07	-0.10
Percent difference	Medium	-0.02	-0.04	-0.18	-0.38	-0.74
	High	-0.04	-0.08	-0.48	-1.14	-2.14
Income Per Household	Low	-22	-23	-86	-110	-181
Difference in dollars	Medium	-29	-50	-271	-608	-1305
2014 dollars	High	-47	-109	-722	-1837	-3758

Summary Findings

In its current form, the employee benefits tax adds more complexity to an already uncertain health care system. Given its design, the relative impact of the health benefits excise tax is highly sensitive to how fast premiums grow. This analysis indicates that under different projections for premium growth, many employers with ordinary levels of health benefits will be hit by the tax on employee health benefits.

This study estimates that between 5 percent and 12 percent of employees would be affected by the tax when it begins in 2018, depending on how fast health insurance premiums rise between now and then. By 2035, under the medium (6%) premium growth scenario, more than 80 percent of employees would be affected by the tax. Under the high (8%) premium growth scenario, more than 97 percent of employees would be affected by 2035. Even under the low (4%) premium growth scenario, nearly one-quarter of all workers would face the tax by then.

Moreover, the tax will also have important implications for overall economic growth and employment. In the worst-case scenario of rapidly rising health care premiums, the damage could exceed 1.5 percent of GDP and more than 2.5 million jobs.