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## The Economic Impact of the U.S. Healthcare Bill: Initial Thoughts

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We see little impact on the near term macroeconomic outlook from the healthcare bill passed by Congress on Sunday. Over the medium-term however this bill is likely to boost the federal budget deficit which in turn may put upward pressure on interest rates. The congressional budget office (CBO) on March 20th released their final estimate of the direct spending and revenue effects of the joint senate bill (H.R. 3590) and the accompanying Reconciliation Act of 2010 passed by the house earlier this week (H.R. 4872). In their final analysis the CBO concluded that the legislation will likely result in a deficit reduction of about \$143 billion from 2010 to 2019 compared to what would be expected under the previous law. However this projection has met a high degree of scepticism as it reflects the CBO's practice of accepting legislation at face value.

The CBO estimates that the legislation will reduce the deficit in spite of a combined increase in spending on Medicaid, subsidies and tax credits of about \$940B over the next 10 years. This is because the CBO projects that, based on the legislation being enacted as stated, there will be a \$525 billion increase in revenues and \$455 billion in savings as the costs of Medicare are reduced relative to what likely would have occurred without the new bill. The main debate is centred on how realistic it is to assume that these revenue increases and cost savings will be realized.

Most of the new revenues are expected to come from increased taxes and fees (about 80% of the total projected increase). However most of these taxes do not take effect until after 2013, with some (like the excise taxes proposed on high-end insurance plans) only coming into effect in 2018. As a result, the bill will not generate significant revenue gains in the near-term as the bulk of the forecasted increase in tax revenues (about 80%) will be generated in the 2015-2019 period. This raises the risk that Congress could repeal the tax hikes as those dates approach.

Perhaps the more contentious issue is that most of the cost savings in the CBO analysis result from a \$455 billion reduction in the cost of Medicare relative to projections based on previous law. Given past failed attempts to limit the growth of Medicare spending, this is questionable.

Uncertainty about Congress following through with tax increases as the implementation dates approach and the likelihood that the estimate for \$455 billion in cost savings from Medicare proves to be optimistic, means that the health-care bill in its current form, could significantly increase the federal budget deficit over the next decade. With the government already running record deficits and the cost of social security rising, uncertainty about the government's ability to fund future spending commitments raises the prospect that interest rates will have to rise to attract capital. These developments, over time, may require the government to shift its policy toward fiscal restraint.

### Short-run Impact

We expect that there will be little near-term impact on the economic outlook from the passage of the healthcare bill. Most of the changes proposed in the bill do not take effect until 2013-2014 meaning that the impact will be more of a medium-term event. One area where some have suggested that we could see some near-term impact is in labour markets. The requirements for larger firms (over 50 employees) to provide health insurance to their employees or pay a fine would effectively increase the cost of hiring, potentially resulting in fewer new hires. However, larger firms are also much more likely to already offer health insurance for their employees (over 95% of firms with over 50 employees offered health insurance last year<sup>1</sup>) so the effect from this policy is expected to be limited.

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## Long-run Impact

Our initial take is that the long-run impact of the healthcare bill as it stands now will depend largely on its impact on the federal budget deficit. The concern is that the forecasted revenue increases and cost-savings in the bill will prove to be optimistic resulting in an increase in an already unsustainably large budget deficit. In addition to raising borrowing costs and acting as a drag on private investment, this budget deficit would eventually require contractionary fiscal policy with some combination of rising taxes and/or declining expenditures. Sizing the net impact will largely hinge on assessing how much offset to the fiscal drag could come from so-called “efficiency gains.”

## Summary of the Impact of the Healthcare Bill

### Insurance Markets

- ▲ Starting this year, legislation would bar insurers from excluding children with pre-existing medical conditions and prevent insurers from arbitrarily dropping policy holders. Parents will be able to keep children on their coverage up to age 26.
- ▲ The legislation creates a high-risk insurance pool to provide immediate affordable insurance for adults who are currently uninsured because of pre-existing health conditions.
- ▲ Beginning in 2014, health insurance exchanges will be created in which small businesses and individuals without employer-sponsored coverage would shop for insurance plans. Once the exchange opens, insurers will no longer be able to turn away people with pre-existing medical conditions or charge them higher premiums.

### Subsidies and Medicaid

- ▲ Beginning in 2014, individuals will be required to obtain health insurance or face fines. Subsidies will be provided to lower-income citizens to help cover the cost.
- ▲ Firms with more than 50 workers who do not offer medical coverage would face fines beginning in 2014.
- ▲ Small businesses will receive tax credits, starting immediately, for offering health coverage to their work force.
- ▲ Federal subsidies would be provided for those with incomes up to 400% of the poverty level to purchase coverage on the new insurance exchanges.
- ▲ Beginning in 2014 Medicaid would be available for everyone with incomes up to 133% of the poverty level.
- ▲ Starting now, Americans who fall into the “donut hole” drug benefit coverage gap will receive a \$250 subsidy to help pay for prescriptions in 2010. Starting in 2011, those individuals will receive a 50% discount on brand-name drugs. The total cost of this program is estimated at about \$42.6 billion over the next decade.

### Financing

- ▲ \$210 billion is expected to be raised over 10 years from increased payroll and investment income taxes on individuals earning more than \$200,000 annually and \$250,000 annually for married couples for Medicare by 2013.
- ▲ \$107 billion is expected to be raised from increased fees on insurance companies, drug makers and medical device manufacturers over the next 10 years.
- ▲ A 40% excise tax would be imposed on high-cost health insurance plans, however this would not be implemented until 2018. This provision is expected to raise \$32 billion based on the CBO’s analysis.
- ▲ The legislation cuts an estimated \$455 billion over 10 years from projected payment increases to the Medicare, Medicaid and CHIP programs.

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<sup>1</sup> Kaiser Family Foundation and Health Research and Educational Trust. “Employer Health Benefits: 2009 Annual Survey.”

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