

IMPLICIT MARGINAL TAX RATES UNDER THE HEALTH SECURITY ACT

Under the Health Security Act (H.R. 3600), employers would be responsible for paying at least 80 percent of their workers' health insurance premiums, with employees and their families responsible for the rest.² Subsidies would be provided for both the employer and family shares of the premium. Beneficiaries of AFDC or Supplemental Security Income and people whose income was below a very low threshold (\$1,025 in 1995) would not have to pay the family portion of the premium for plans with premiums at or below the weighted average for that type of family.

Families with income above \$1,025 would be required to pay some or all of their share of the premium. Those with income equal to the poverty level would have to pay 3 percent of family income toward the family share; therefore, between income of \$1,025 and the poverty level, a family's obligation for the premium would rise by slightly more than 3 percent of wages in excess of \$1,025. Families with income equal to 150 percent of the poverty level would be required to pay the entire family premium. Thus, between 100 percent and 150 percent of the poverty level, the family share would increase at a rate that would fully pay the family obligation (20 percent of the weighted

2. Overall, employers within a regional alliance would pay 80 percent of the premium costs for full-time workers. The actual employer share for a particular type of family would depend on the number of workers in that family type within the regional alliance. Employers would pay a smaller share of premiums for part-time workers. For a further description of the calculation of premium contributions, see Congressional Budget Office, *An Analysis of the Administration's Health Proposal*, pp. 9-10.

average premium) at 150 percent of the poverty level. However, the family's actual obligation would be capped at 3.9 percent of income for families earning less than \$41,000 in 1995. As a result, most families with income equal to 150 percent of the poverty level would still receive some subsidy for the family portion of the premium. The act would also provide cost-sharing subsidies for some families below 150 percent of the poverty level.

This subsidy schedule could result in three marginal rates for subsidized families at different income levels. For example, in 1995 a single individual would face a marginal rate of just over 3 percent on income between \$1,025 and \$7,520 (the estimated one-person poverty level for 1995) as a result of the subsidy mechanism. For wages between \$7,520 and \$10,751, the individual would face a marginal rate of approximately 6 percent. Because the family share would be capped at 3.9 percent of income, the marginal rate would fall to 3.9 percent at \$10,751, the point at which the cap would take effect. The marginal rate from the subsidy schedule would fall to zero at an income of \$11,564, when the family would have paid its entire share of the premium.³

Other provisions of the Health Security Act would add to the implicit marginal tax rates for some workers, but these provisions vary with the

3. In this example, the individual premium is assumed to be \$2,255, and the family share of the premium is 20 percent, or \$451. At the poverty level, the individual would have paid \$226 of the family share. At wages of \$10,751, the individual would have paid an additional \$194. At \$11,564, the individual would have paid the remaining \$31.

characteristics of the employer rather than those of particular employees. For example, firms in a corporate alliance would pay a tax equal to 1 percent of their payroll. Under the assumption that employers would pass on the tax to their workers in the form of lower wages, all employees in such firms would face tax rates higher than those caused by the phaseout of the family subsidy. (In the case of a worker whose firm was in a corporate alliance, the tax rate would not rise by a full percentage point because the compensation that would no longer be paid in cash would no longer be subject to other taxes.) The rates calculated in this memorandum do not include this 1 percent tax. Workers are assumed to be in firms that have not established corporate alliances.

The Health Security Act would also provide subsidies to employers based on the size of the firm and its average wage level. The smallest, lowest-wage firms would receive the largest subsidies. These subsidies would guarantee that employers' health insurance costs did not exceed specified shares of their total payroll. The maximum cap on health expenses would be 7.9 percent of wages paid, with lower caps applying to smaller firms.

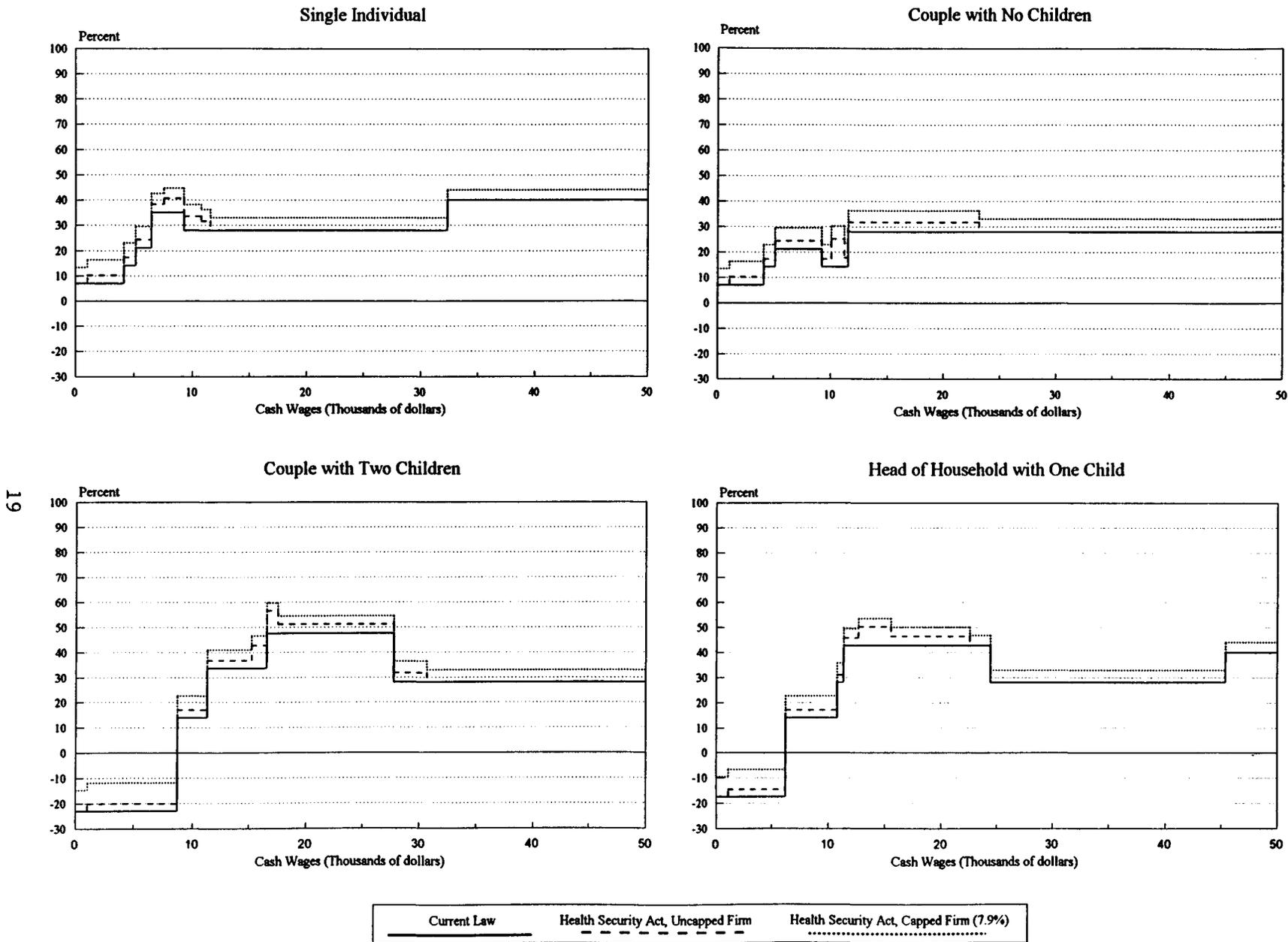
The implicit marginal tax rates in the Health Security Act that would be generated by the phaseout of subsidies are functions of the applicable poverty level for a family and its health insurance premium. (The calculations here do not include any effects of cost-sharing subsidies.) In the examples shown in

Figure 2 and Table 3, the poverty levels are based on family size, except for the case of the head of household with one child--which, under the Health Security Act, is considered a family of three for the purpose of calculating the subsidy.

The phaseout of the family subsidy under the proposal would increase marginal tax rates by about 3 percentage points in 1995 for income between \$1,025 and the poverty level (see Figure 2 and Table 3). Between the poverty level and the point at which the family share of the premium equaled 3.9 percent of income, the rate would increase by amounts ranging from 6 to 11 percentage points for the four family types CBO examined. This higher rate would apply over a relatively narrow income range. Above this range, an additional marginal rate of nearly 4 percentage points would apply, up to the point where the subsidy ends (where 3.9 percent of income is equal to the family share).

Other workers who would face a higher marginal tax rate are those whose employer had health insurance costs higher than the 7.9 percent of payroll cap specified by the bill (see Figure 2 and Table 3). These employers would have to pay an additional 7.9 cents for health insurance if they raised an employee's wages by one dollar. Small or low-wage firms would have lower caps on health insurance costs. About half of all employees work for firms in

FIGURE 2. IMPLICIT MARGINAL TAX RATES FOR 1995 UNDER CURRENT LAW AND THE HEALTH SECURITY ACT



SOURCE: Congressional Budget Office.

NOTE: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. All marginal rates include the income tax and the Social Security payroll tax. The earned income tax credit is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

TABLE 3. IMPLICIT MARGINAL TAX RATES FOR 1995, AND WAGE LEVELS AT WHICH RATES CHANGE, UNDER THE HEALTH SECURITY ACT

	Wage Level (Dollars)	Marginal Rate Under Current Law (Percent)	Marginal Rate Under Health Security Act (Percent)	
			Uncapped Firm	Capped Firm ^a
Single Individual				
Start of EITC and Payroll Tax	0	7.1	7.1	13.5
H.R. 3600 Threshold Amount	1,025	7.1	10.3	16.5
End of EITC Phase-in	4,110	14.2	17.4	23.1
Start of EITC Phaseout	5,130	21.3	24.5	29.7
Start of 15 Percent Bracket	6,400	35.3	38.5	42.7
Poverty Level	7,520	35.3	40.8	44.9
End of EITC Phaseout	9,240	28.1	33.7	38.2
3.9 Percent Limit				
on Premium Share	10,751	28.1	31.8	36.4
Premium Share Fully Paid	11,564	28.1	28.1	33.1
Start of 28 Percent Bracket	32,313	40.2	40.2	44.3
Memorandum:				
Assumed Premium	2,255	n.a.	n.a.	n.a.
Couple with No Children				
Start of EITC and Payroll Tax	0	7.1	7.1	13.5
H.R. 3600 Threshold Amount	1,025	7.1	10.2	16.3
End of EITC Phase-in	4,110	14.2	17.3	23.0
Start of EITC Phaseout	5,130	21.3	24.4	29.6
End of EITC Phaseout	9,240	14.2	17.3	23.0
Poverty Level	10,080	14.2	25.3	30.4
3.9 Percent Limit				
on Premium Share	11,214	14.2	17.8	23.5
Start of 15 Percent Bracket	11,550	28.1	31.8	36.4
Premium Share Fully Paid	23,128	28.1	28.1	33.1
Memorandum:				
Assumed Premium	4,510	n.a.	n.a.	n.a.

(Continued)

TABLE 3. CONTINUED

	Wage Level (Dollars)	Marginal Rate Under Current Law (Percent)	Marginal Rate Under Health Security Act (Percent)	
			Uncapped Firm	Capped Firm ^a
Couple with Two Children				
Start of EITC and Payroll Tax	0	-22.9	-22.9	-14.5
H.R. 3600 Threshold Amount	1,025	-22.9	-20.0	-11.8
End of EITC Phase-in	8,650	14.2	17.2	22.9
Start of EITC Phaseout	11,290	33.8	36.8	41.1
Poverty Level	15,200	33.8	42.8	46.7
Start of 15 Percent Bracket	16,550	47.7	56.7	59.7
3.9 Percent Limit				
on Premium Share	17,548	47.7	51.3	54.7
End of EITC Phaseout	27,719	28.1	31.8	36.4
Premium Share Fully Paid	30,646	28.1	28.1	33.1
Memorandum:				
Assumed Premium	5,976	n.a.	n.a.	n.a.
Head of Household with One Child				
Start of EITC and Payroll Tax	0	-17.4	-17.4	-9.3
H.R. 3600 Threshold Amount	1,025	-17.4	-14.3	-6.5
End of EITC Phase-in	6,160	14.2	17.2	22.9
Start of 15 Percent Bracket	10,750	28.1	31.2	35.9
Start of EITC Phaseout	11,290	43.0	46.0	49.7
Poverty Level ^b	12,640	43.0	50.3	53.7
3.9 Percent Limit				
on Premium Share	15,474	43.0	46.6	50.3
Premium Share Fully Paid	22,549	43.0	43.0	46.9
End of EITC Phaseout	24,396	28.1	28.1	33.1
Start of 28 Percent Bracket	45,375	40.2	40.2	44.3
Memorandum:				
Assumed Premium	4,397	n.a.	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTES: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. Marginal rates include the income tax and Social Security payroll tax. The earned income tax credit (EITC) is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

n.a. = not applicable.

- a. Firm's expenses for health insurance are capped at 7.9 percent of payroll.
b. The Health Security Act considers a head of household with one child a family of three for the purpose of setting the poverty level.

which employer health care costs would be capped as a percentage of payroll. Since 7.9 percent is the maximum rate for the cap, the dotted lines in Figure 2 show the upper bound for implicit marginal rates that would affect these workers. Employees in small or low-wage firms would have lower rates because of the lower caps that would apply to these firms.⁴

The 7.9 percent cap would interact with other marginal tax rates in a manner similar to the employer share of the Social Security payroll tax (see Table 4). Again, consider an employee paid \$20,000 in total compensation, including the payroll tax and, in this example, the employer share of health insurance premiums. In order to pay that worker an additional \$1,000 in compensation, the employer would have to set aside \$66 for Social Security taxes and \$68 for health insurance premiums. After the employee had paid Social Security and income taxes, he or she would be left with \$669 out of the \$1,000, thus facing an implicit marginal tax rate of 33.1 percent. This rate compares with the marginal rate under current law of 28.1 percent (see Table 1).⁵ (The additional marginal rate of 5 percentage points in this example is less than 7.9 percent because taxes would be paid after the 7.9 percent charge had been deducted.)

4. Not all workers in a firm would necessarily benefit from the payroll cap. A high-wage worker in a firm with low average wages could generate a payroll surcharge in excess of any health insurance benefit.

5. The examples are designed to show the different implicit marginal tax rates that apply with and without the payroll cap. Because the first example does not include employer-provided health insurance, other comparisons may not be meaningful. For example, the levels of cash wages and after-tax income in Table 4 have been calculated after the payment for health insurance premiums, and Table 1 contains no such provision for health insurance.

TABLE 4. INTERACTION OF EMPLOYER PAYROLL TAXES AND EMPLOYEE INCOME TAXES UNDER THE HEALTH SECURITY ACT FOR A SINGLE INDIVIDUAL EMPLOYED BY A CAPPED FIRM (In dollars)

	Base Salary	Increased Salary	Change
Employer Costs			
Total Compensation	20,000	21,000	1,000
Employer Share of OASDI and HI Taxes (7.65 percent of wages paid)	1,324	1,390	66
Employer Share of Premiums (7.9 percent of wages paid)	1,367	1,436	68
Wages Paid to Employee	17,309	18,174	865
Employee Costs			
Employee Share of OASDI and HI Taxes (7.65 percent of wages paid)	1,324	1,390	66
Employee's Taxable Income (Single filer in 1995)			
Wages paid to employee	17,309	18,174	865
Personal exemption	-2,500	-2,500	0
Standard deduction	<u>-3,900</u>	<u>-3,900</u>	<u>0</u>
Total Taxable Income	10,909	11,774	865
Federal Income Tax (15 percent tax rate)	1,636	1,766	130
Income After All Taxes Have Been Paid	14,349	15,018	669
Total			
Total Taxes Paid by Employee and Employer Plus Employer Premium	5,651	5,982	331

SOURCE: Congressional Budget Office.

NOTES: Firm's expenses for health insurance are capped at 7.9 percent of payroll. This employee would receive no direct subsidy because the cash wages are above CBO's estimated eligibility level for 1995 of \$11,564.

Out of \$1,000 additional compensation paid by the employer, the employee would get \$669 and the federal government and the regional health alliance would receive a total of \$331. In other words, the federal government and the regional health alliance would receive an additional 33.1 percent in taxes and premium contributions on each additional dollar of compensation paid.

OASDI = Old-Age, Survivors, and Disability Insurance; HI = Hospital Insurance.

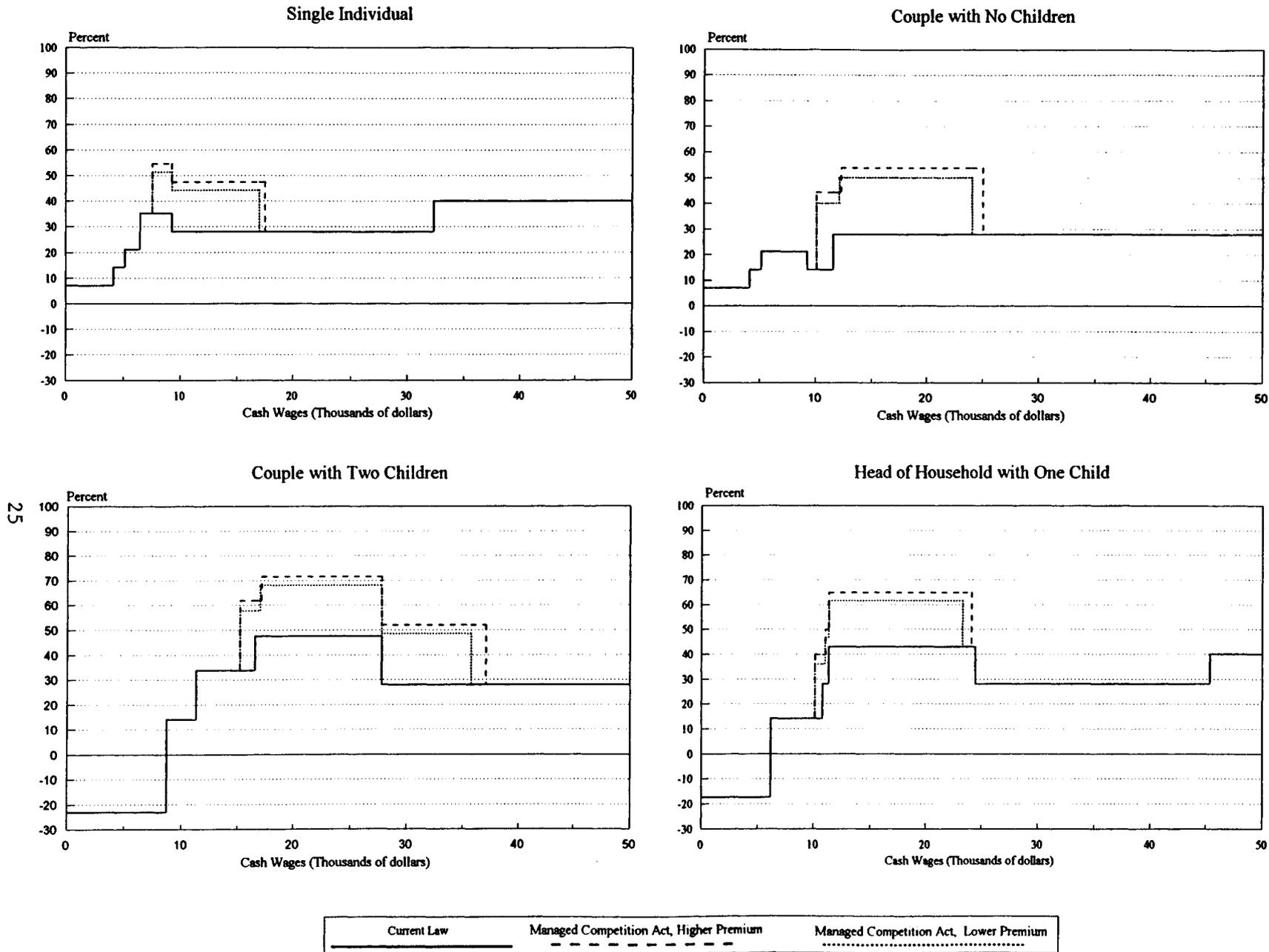
IMPLICIT MARGINAL TAX RATES UNDER THE MANAGED COMPETITION ACT

Under the Managed Competition Act (H.R. 3222), individuals and families below the poverty level would have their premiums fully subsidized up to the amount of the lowest premium charged by a qualifying health plan (the so-called reference premium). The subsidy would be reduced if financing fell short. These subsidies would be phased out between 100 percent and 200 percent of the poverty level for each family size.⁶ Premiums paid by an individual or family would be fully deductible for income tax purposes up to the level of the reference premium.

Figure 3 and Table 5 show implicit marginal tax rates under the Managed Competition Act compared with those under current law. These implicit rates take into account the interaction between the subsidy rate and the deductibility of premiums paid. (As with the Health Security Act, the effect of cost-sharing subsidies is not included.) All of the examples assume that the individual or family obtains insurance through a health plan purchasing cooperative and that the employer does not pay any portion of the health

6. The proposal indicates that the poverty level would be adjusted on a state-by-state basis. The examples calculated by CBO use the national poverty levels estimated for 1995.

FIGURE 3. IMPLICIT MARGINAL TAX RATES FOR 1995 UNDER CURRENT LAW AND THE MANAGED COMPETITION ACT



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SOURCE: Congressional Budget Office.

NOTE: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. All marginal rates include the income tax and the Social Security payroll tax. The earned income tax credit is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

TABLE 5. IMPLICIT MARGINAL TAX RATES FOR 1995, AND WAGE LEVELS AT WHICH RATES CHANGE, UNDER THE MANAGED COMPETITION ACT

	Wage Level (Dollars)	Marginal Rate Under Current Law (Percent)	Marginal Rate Under Managed Competition Act (Percent)	
			Higher Premium	Lower Premium
Single Individual				
Start of EITC and Payroll Tax	0	7.1	7.1	7.1
End of EITC Phase-in	4,110	14.2	14.2	14.2
Start of EITC Phaseout	5,130	21.3	21.3	21.3
Start of 15 Percent Bracket				
Under Current Law	6,400	35.3	35.3	35.3
Start of Subsidy (Poverty level)	7,520	35.3	54.6	51.5
End of EITC Phaseout	9,240	28.1	47.5	44.4
End of Subsidy				
Higher premium	16,995	28.1	47.5	28.1
Lower premium	17,484	28.1	28.1	28.1
Start of 28 Percent Bracket	32,313	40.2	40.2	40.2
Memorandum:				
Assumed Premium				
Higher	2,444	n.a.	n.a.	n.a.
Lower	1,955	n.a.	n.a.	n.a.
Couple with No Children				
Start of EITC and Payroll Tax	0	7.1	7.1	7.1
End of EITC Phase-in	4,110	14.2	14.2	14.2
Start of EITC Phaseout	5,130	21.3	21.3	21.3
End of EITC Phaseout	9,240	14.2	14.2	14.2
Start of Subsidy (Poverty level)	10,080	14.2	44.5	40.2
Start of 15 Percent Bracket				
Current law	11,550	28.1	44.5	40.2
Lower premium	12,120	28.1	44.5	50.2
Higher premium	12,263	28.1	53.9	50.2
End of Subsidy				
Lower premium	24,069	28.1	53.9	28.1
Higher premium	25,046	28.1	28.1	28.1
Memorandum:				
Assumed Premium				
Higher	4,886	n.a.	n.a.	n.a.
Lower	3,909	n.a.	n.a.	n.a.

(Continued)

TABLE 5. CONTINUED

	Wage Level (Dollars)	Marginal Rate Under Current Law (Percent)	Marginal Rate Under Managed Competition Act (Percent)	
			Higher Premium	Lower Premium
Couple with Two Children				
Start of EITC and Payroll Tax	0	-22.9	-22.9	-22.9
End of EITC Phase-in	8,650	14.2	14.2	14.2
Start of EITC Phaseout	11,290	33.8	33.8	33.8
Start of Subsidy	15,200	33.8	62.0	57.8
Start of 15 Percent Bracket				
Current law	16,550	47.7	62.0	57.8
Lower premium	17,022	47.7	62.0	68.2
Higher premium	17,140	47.7	71.7	68.2
End of EITC Phaseout	27,719	28.1	52.2	48.6
End of Subsidy				
Lower premium	35,713	28.1	52.2	28.1
Higher premium	37,041	28.1	28.1	28.1
Memorandum:				
Assumed Premium				
Higher	6,641	n.a.	n.a.	n.a.
Lower	5,313	n.a.	n.a.	n.a.
Head of Household with One Child				
Start of EITC and Payroll Tax	0	-17.4	-17.4	-17.4
End of EITC Phase-in	6,160	14.2	14.2	14.2
Start of Subsidy	10,080	14.2	40.1	36.1
Start of 15 Percent Bracket				
Current law	10,750	28.1	40.1	36.1
Lower premium	10,957	28.1	40.1	46.8
Higher premium	11,008	28.1	50.1	46.8
Start of EITC Phaseout	11,290	43.0	65.0	61.6
End of Subsidy				
Lower premium	23,268	43.0	65.0	43.0
Higher premium	24,045	43.0	43.0	43.0
End of EITC Phaseout	24,396	28.1	28.1	28.1
Start of 28 Percent Bracket	45,375	40.2	40.2	40.2
Memorandum:				
Assumed Premium				
Higher	3,885	n.a.	n.a.	n.a.
Lower	3,108	n.a.	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTES: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. Marginal rates include the income tax and Social Security payroll tax. The earned income tax credit (EITC) is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax. n.a. = not applicable.

insurance premium.⁷ CBO has estimated the effects of the Managed Competition Act under two different benefit packages and levels of premiums (see *An Analysis of the Managed Competition Act*, April 1994). Figure 3 and Table 5 present marginal rates generated under both sets of premiums.

The implicit marginal rates caused by phasing out the subsidy in the Managed Competition Act would apply for families with adjusted gross income (AGI) between the poverty level and twice that amount. The actual amount of the subsidy would be based on the family's AGI. (A family at or below the poverty level would receive a subsidy equal to the premium for a low-cost plan; a family at 200 percent of poverty would receive no subsidy.) In addition, the unsubsidized portion of the premium would be tax-deductible in calculating AGI. Thus, the subsidy would be a function of AGI, and AGI would be a function of the subsidy. When wages rose, out-of-pocket premium costs would increase, but so would the deduction for these out-of-pocket expenses. The increased deduction would reduce AGI, which in turn would lower out-of-pocket premium expenses.

A stable formula exists for computing the subsidy. The formula depends on the ratio of the premium to the poverty level (R). When wages are greater

7. Subsidies would be reduced dollar for dollar by employer contributions for health insurance. Thus, excluding other considerations, neither the employer nor its low-income workers would see any advantage in having the employer pay for health insurance.

than the poverty level and are the only source of income, the formula would be:

$$\text{Nonsubsidized portion} = \frac{R}{1+R} \times (\text{wages} - \text{poverty level})$$

$$\text{Subsidy} = \text{Premium} - \text{nonsubsidized portion}$$

$$\text{where } R = \frac{\text{premium}}{\text{poverty level}}$$

For example, in the case of a single individual with \$10,000 in wages and a premium of \$2,444, the subsidy would be calculated as follows:

$$\begin{aligned} \text{Nonsubsidized portion} &= 0.2452 \times (\$10,000 - 7,520) \\ &= \$608 \end{aligned}$$

$$\text{Subsidy} = \$2,444 - 608 = \$1,836.$$

As a taxpayer's wages rose above the poverty level, he or she would lose the subsidy at rate $R/(1+R)$. This loss would introduce an additional implicit marginal tax rate of that amount. The single individual in the above example would lose 24.5 cents of subsidy for each additional dollar of wages. However, the individual would get an additional 24.5 cent deduction from taxable income; at a 15 percent marginal tax rate, income taxes would fall by 3.7 cents. The net

change in subsidy and taxes is 20.8 cents--a 20.8 percent additional marginal rate on wages. The additional marginal rate on compensation would be 19.3 percent.

The deductibility of the unsubsidized portion of premiums has two effects on measured marginal rates, which are presented in terms of wages rather than AGI (see Figure 3). Deductibility raises the wage level at which the 15 percent bracket begins because, as compared with current law, the deductible portion would produce lower taxable income for the same level of wages. Also, the subsidy would end when AGI equals 200 percent of the poverty level. Since the taxpayer would get a full deduction for the premium at that point, the subsidy, when presented in terms of wages, ends at twice the poverty level plus the value of the premium.

In the examples shown in Figure 3 and Table 5, the phaseout of the subsidy would raise marginal tax rates on compensation from 17 percentage points for a single individual under the lower premium to a maximum of 33 percentage points for a couple with no children under the higher premium. Because premium amounts are expected to grow faster than the poverty thresholds, which are indexed to the consumer price index, the implicit marginal tax rate from the subsidy phaseout would grow over time.

The rates shown here were calculated with the two premium levels assumed by CBO in *An Analysis of the Managed Competition Act*--the premium for the comprehensive benefit package and the premium for the 20 percent less comprehensive, or "limited," benefit package. The different premium levels would produce similar changes in marginal tax rates, although with two variations. First, in each example, the lower assumed premium results in a lower marginal rate since less of a subsidy would be phased out. Second, that premium also lowers the income level at which the phaseout of the subsidy would end. The phaseout is supposed to stop when AGI equals 200 percent of the poverty level. Since the unsubsidized premium would be fully deductible, the phaseout of the lower premium ends at a lower level of wages.

PUTTING MARGINAL TAX RATES UNDER THE TWO PROPOSALS IN CONTEXT

The phaseout of subsidies in the Health Security Act and the Managed Competition Act would increase implicit marginal tax rates over certain income ranges, including ranges in which some people are already subject to high implicit marginal tax rates because of the phaseout of other benefits.

The actual impact of these rates on employment and work effort is uncertain. For one thing, workers would respond to the higher rates only to

the extent they were aware that their return from working had decreased. The elements of these proposals that produce higher rates would have varying degrees of visibility to workers. For another thing, the two proposals would provide incentives for firms to react in ways that would maximize subsidies to both the employers and their employees. The Health Security Act would create incentives for workers and firms to reorganize--sorting workers by level of wage--because of its subsidies to firms. The Managed Competition Act would also create incentives for sorting because workers receiving subsidies would be better off paying for their insurance directly, whereas unsubsidized workers would prefer to have employers pay for insurance. The amount of sorting that would take place under a new health care system is unknown. But the degree to which it occurred would affect the number of workers receiving subsidies and the implicit marginal rates they would face.

Marginal tax rates would generally be higher under the Managed Competition Act than under the Health Security Act. Although higher marginal rates would increase work disincentives, three other factors should be considered in evaluating their relative importance.

First, the higher marginal tax rates of the Managed Competition Act would apply to fewer workers than would those of the Health Security Act. CBO estimates that approximately half of all workers would be in firms with

payroll caps under the Health Security Act. All such workers would face higher additional marginal rates from these caps, regardless of their income. Under the Managed Competition Act, the implicit marginal tax rates would apply only to workers in families with income between the poverty level and twice the poverty level--fewer than 15 percent of all employees.

Second, factors other than marginal tax rates would affect work incentives. The Managed Competition Act might provide stronger incentives for workers to enter the labor force than the Health Security Act. Individuals wanting health insurance would have no obligation to pay for it under the Managed Competition Act as long as their family income was less than the poverty level. Subsidies for health insurance would be a function of family income rather than work status. Under the Health Security Act, a low-income individual outside the work force would pay little or nothing for insurance. A decision by that individual to enter the labor force would trigger the payment by the employer of its share of the premium, and this payment would be borne by most workers in the form of lower cash wages or other fringe benefits. Relative to the Managed Competition Act, this additional cost would produce a disincentive for workers to enter the labor force.

Third, the reduced economic efficiency associated with higher marginal rates must be weighed against the benefits of the subsidies associated with

those rates. The benefits of a larger subsidy could outweigh the negative effects of a higher marginal rate on work incentives. For example, single individuals with wages at the poverty level and no other source of income would face a marginal rate on compensation of 40.8 percent under the Health Security Act and 54.6 percent under the Managed Competition Act with the higher assumed premium. Under the Managed Competition Act, such people could have the value of their premiums fully subsidized. Under the assumption of a higher premium, the subsidy would be worth \$2,444 in 1995. Under the Health Security Act, a working individual in an uncapped firm with income at the poverty level would receive a subsidy only on the family share of the premium, worth about \$225 in 1995. In this particular case, the higher marginal tax rate under the Managed Competition Act would result from the phaseout of a significantly higher subsidy.⁸ In other cases, subsidies (and implicit marginal rates) would be greater under the Health Security Act.⁹

As mentioned earlier, this memorandum focuses on only one aspect of the subsidies that would be provided under proposals to restructure the health insurance market. Work disincentives created by higher marginal tax rates

8. The exact amount of the subsidy under the Health Security Act would depend on the demographic characteristics of a particular regional alliance. Some cross-subsidization would occur from families with more than one worker to families with one worker, so the number of families and the number of workers within the alliance would determine the extent of such subsidization.

9. For example, a worker with income just above 200 percent of the poverty level would receive no subsidy under the Managed Competition Act. If that same worker was employed in a firm subject to the payroll cap, the employer and ultimately the worker would receive a subsidy and face a higher marginal rate as a result of the payroll cap.

should be compared not only with the value of subsidies, which clearly make their recipients better off, but also with all of the other components of the restructured system. High marginal tax rates by themselves should not disqualify a proposal. If desired, such rates can be reduced by lowering the amount of subsidies provided or expanding the range of income over which the subsidies are phased out.

APPENDIX: ADDITIONAL TABLES

TABLE A-1. IMPLICIT MARGINAL TAX RATES FOR 1995 ON WAGES AND COMPENSATION, AND WAGE LEVELS AT WHICH RATES CHANGE, UNDER CURRENT LAW

	Wage Level (Dollars)	Marginal Income Tax Rate on Wages (Percent)	Marginal Income and Payroll Tax Rate on Compensation (Percent)
Single Individual			
Start of EITC and Payroll Tax	0	-7.7	7.1
End of EITC Phase-in	4,110	0	14.2
Start of EITC Phaseout	5,130	7.7	21.3
Start of 15 Percent Bracket	6,400	22.7	35.3
End of EITC Phaseout	9,240	15.0	28.1
Start of 28 Percent Bracket	32,313	28.0	40.2
Maximum Wages Subject to OASDI Tax	62,100	28.0	30.5
Start of 31 Percent Bracket	73,813	31.0	33.4
Start of Exemption and Deduction Limit	114,750	32.6	34.9
Start of 36 Percent Bracket	148,515	37.8	40.1
End of Exemption Limit	239,750	37.1	39.4
Start of 39.6 Percent Bracket	313,304	40.8	43.1
One-Earner Couple with No Children			
Start of EITC and Payroll Tax	0	-7.7	7.1
End of EITC Phase-in	4,110	0	14.2
Start of EITC Phaseout	5,130	7.7	21.3
End of EITC Phaseout	9,240	0	14.2
Start of 15 Percent Bracket	11,550	15.0	28.1
Start of 28 Percent Bracket	55,000	28.0	40.2
Maximum Wages Subject to OASDI Tax	62,100	28.0	30.5
Start of Deduction Limit	114,750	28.8	31.3
Start of 31 Percent Bracket	123,786	31.9	34.3
Start of Exemption Limit	172,100	33.2	35.6
Start of 36 Percent Bracket	182,789	38.5	40.8
End of Exemption Limit	297,100	37.1	39.4
Start of 39.6 Percent Bracket	313,304	40.8	43.1

(Continued)

TABLE A-1. CONTINUED

	Wage Level (Dollars)	Marginal Income Tax Rate on Wages (Percent)	Marginal Income and Payroll Tax Rate on Compensation (Percent)
One-Earner Couple with Two Children			
Start of EITC and Payroll Tax	0	-40.0	-22.9
End of EITC Phase-in	8,650	0	14.2
Start of EITC Phaseout	11,290	21.1	33.8
Start of 15 Percent Bracket	16,550	36.1	47.7
End of EITC Phaseout	27,719	15.0	28.1
Start of 28 Percent Bracket	61,250	28.0	40.2
Maximum Wages Subject to OASDI Tax	62,100	28.0	30.5
Start of Deduction Limit	114,750	28.8	31.3
Start of 31 Percent Bracket	129,810	31.9	34.3
Start of Exemption Limit	172,100	34.4	36.8
Start of 36 Percent Bracket	187,814	40.0	42.2
End of Exemption Limit	297,100	37.1	39.4
Start of 39.6 Percent Bracket	313,304	40.8	43.1
Head of Household with One Child			
Start of EITC and Payroll Tax	0	-34.0	-17.4
End of EITC Phase-in	6,160	0	14.2
Start of 15 Percent Bracket	10,750	15.0	28.1
Start of EITC Phaseout	11,290	31.0	43.0
End of EITC Phaseout	24,396	15.0	28.1
Start of 28 Percent Bracket	45,375	28.0	40.2
Maximum Wages Subject to OASDI Tax	62,100	28.0	30.5
Start of 31 Percent Bracket	107,250	31.0	33.4
Start of Deduction Limit	114,750	31.9	34.3
Start of Exemption Limit	143,450	33.2	35.6
Start of 36 Percent Bracket	166,702	38.5	40.8
End of Exemption Limit	268,450	37.1	39.4
Start of 39.6 Percent Bracket	313,304	40.8	43.1

SOURCE: Congressional Budget Office.

NOTES: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. Marginal rates include the income tax and Social Security payroll tax. The earned income tax credit (EITC) is calculated at 1996 rates.

OASDI = Old-Age, Survivors, and Disability Insurance.

TABLE A-2. PROJECTED 1995 TAX PARAMETERS, BY FILING STATUS
(In dollars)

	Filing Status		
	Single	Joint	Head of Household
Personal Exemption	2,500	2,500	2,500
Standard Deduction	3,900	6,550	5,750
Taxable Income Bracket			
28 percent starting point	23,350	39,000	31,300
31 percent starting point	56,550	94,300	80,800
36 percent starting point	118,000	143,700	130,850
39.6 percent starting point	256,600	256,600	256,600
Level of Adjusted Gross Income at Which Deduction Limit Begins	114,750	114,750	114,750
Level of Adjusted Gross Income at Which Exemption Limit Begins	114,750	172,100	143,450

SOURCE: Congressional Budget Office.

NOTE: Based on January 1994 economic assumptions.

TABLE A-3. PROJECTED 1995 PARAMETERS FOR THE EARNED INCOME TAX CREDIT (In dollars)

	Number of Children in Household		
	None	One	Two or More
Maximum Earnings Eligible for the Credit	4,110	6,160	8,650
Maximum Credit	314	2,094	3,460
Credit Rate (Percent) ^a	7.65	34.00	40.00
Start of Phaseout	5,130	11,290	11,290
Phaseout Rate (Percent) ^a	7.65	15.98	21.06
End of Phaseout ^a	9,240	24,396	27,719

SOURCE: Congressional Budget Office.

NOTE: Based on January 1994 economic assumptions.

a. Value in 1996 when credit is fully phased in.

