Long-Term Services & Supports Feasibility Policy Note

Notes on the Financing and Economic Impacts of SB 2478, HB 1885

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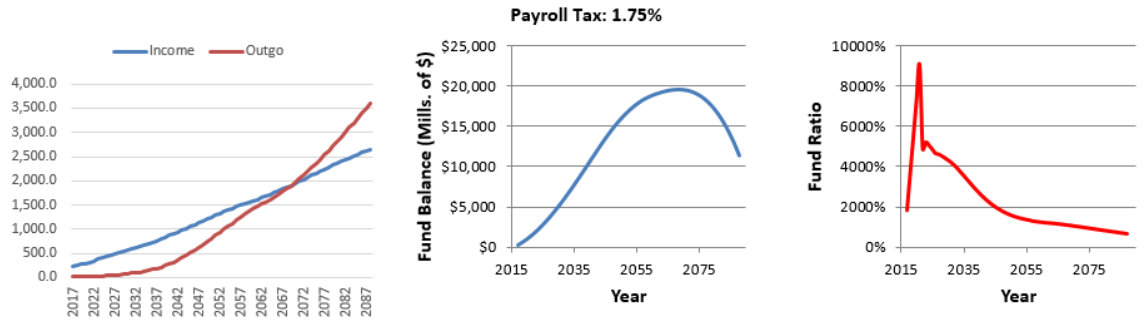
The long-term services and supports public insurance program proposed by SB2478 and HB1885 is a substantial program that will address the needs of caring for kupuna. Even though the program will work to minimize difficulties involved with long-term care of kupuna, we want to design the program to ensure costs do not exceed benefits. Thus, we must carefully analyze the reliability of financing the program, as well as the social and economic impacts of the program, in order to conclude that the program is indeed beneficial to the State of Hawai'i. This testimony will examine the sustainability and the socioeconomic effects of the proposed program.

Financing the Program

Several funding options to finance the program were explored: an income tax, a payroll tax, and a General Excise Tax (GET) surcharge. There is one major issue with an income tax – an income tax would tax retirement benefits. This would be particularly hurtful to current retirees, who likely have not saved with this additional tax on their benefits in mind. A payroll tax is similar to an income tax, but has the advantage of not taxing retirees. A payroll tax is not without its problems however. One important question is whether current retirees, who would not be making nominal payments to the program under this funding mechanism, should receive any benefits. While this question might inspire lively debate, one thing is clear – this program would be unable to afford to give current retirees benefits. Even without distributing benefits to current retirees, it will be quite difficult to sustain the program with a payroll tax. Figure 1 is an example of what happens to the fund with a payroll tax. Regardless of assumptions on the state of the economy and the amount of benefits paid out, the fund balance will start turning

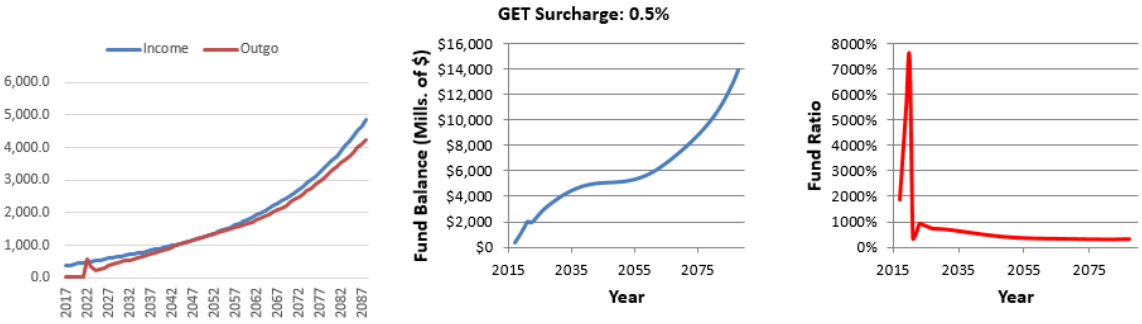
downwards sometime in the future. Under a high payroll tax, good economic conditions, or a small benefit, this downward trajectory will happen much later, but an increase to the payroll tax or a decrease to the benefit will have to happen eventually.

Figure 1



Compare this to a GET surcharge: with a GET surcharge, the fund is very sustainable (see Figure 2). This happens for a couple reasons. First, retirees continue to make small, but not insignificant, contributions to the fund. Second, visitors to Hawai'i, individuals who will likely never use the benefits to the program, will pay up to a third of the fund. Currently, around 30% of GET comes from tourists visiting the State. With a GET surcharge, there is no question about supporting current retirees – it is financially feasible, and since these retirees are making at least a nominal contribution to the fund, they will receive benefits. Figure 2 is based on pessimistic, recession-level projections of the economy. Even if the economy was stuck in a recession for the next 50 years, the fund would continue to grow.

Figure 2



The Economic Impact of a GET Surcharge and a Public Long-Term Care Insurance Program

The economic impact of a GET surcharge was analyzed in two ways: first, a similar GET surcharge, the Honolulu "Rail Tax," was used as a comparison, and second, a regional input-output model was employed.

When looking at the historical example of a GET surcharge, there is little evidence that 0.5% will have an effect on the economy. The "Rail Tax" was implemented in 2007, and applied only to transactions that occurred in the City and County of Honolulu. To determine the impact of a 0.5% GET surcharge, various measures of the economy were compared between the island of O'ahu and the Neighbor Islands, before and after the implementation of the surcharge. Figure 3 provides some graphs of tax intake from industries unaffected by the 0.5% GET surcharge. The graphs are all normalized, by island, to 2002. This establishes that all the islands tend to behave similarly, and confirms the ability to compare the affected sectors across islands.

Figure 3

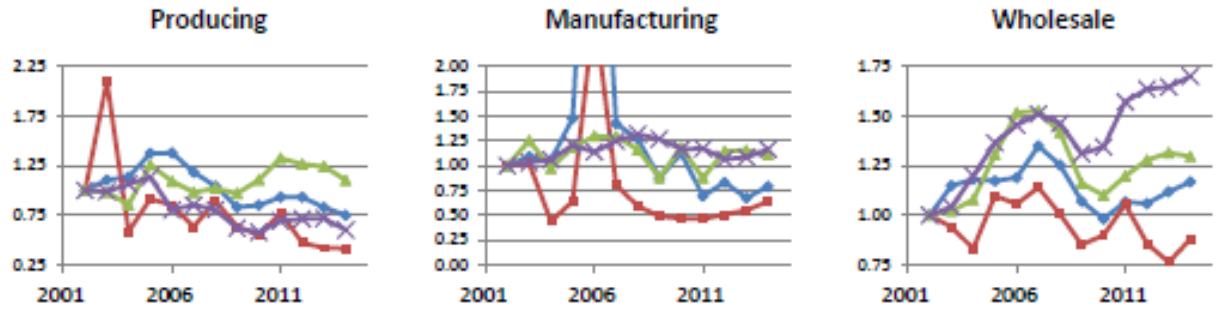


Figure 4 provides graphs for numerous graphs of economic variables – GET collected from the affected industries, income tax and total tax receipts, as well as some labor force variables. Taking all these graphs in Figure 4 together, O'ahu does not negatively stand out. This provides evidence that a 0.5% GET surcharge is not large enough to have a significant, negative impact.

Using a regional input-output model provides a little more nuance to the estimating the negative impact of the tax and the positive impact of distributing benefits. The regional input-output model looks at inter-industry transactions, and estimates the effect of changing the demand of the outputs on the economy. The Type I model assumes that changes in demand only affect the inter-industry usage of inputs, while the Type II model assumes that workers within the affected industries will have an additional impact to the final demand of goods and services; to oversimplify, Type I modelling provides a lower bound for changes to the economy, while Type II modelling provides an upper bound. Figure 5 shows the net benefits to the economy in 10-year blocks. The 0.5% surcharge and the limited initial distribution of benefits leads to a negative GDP and a minimal change to earnings in the first 10 years of the program, but afterwards, the program results in an increase to GDP, earnings, and jobs created.

Figure 4

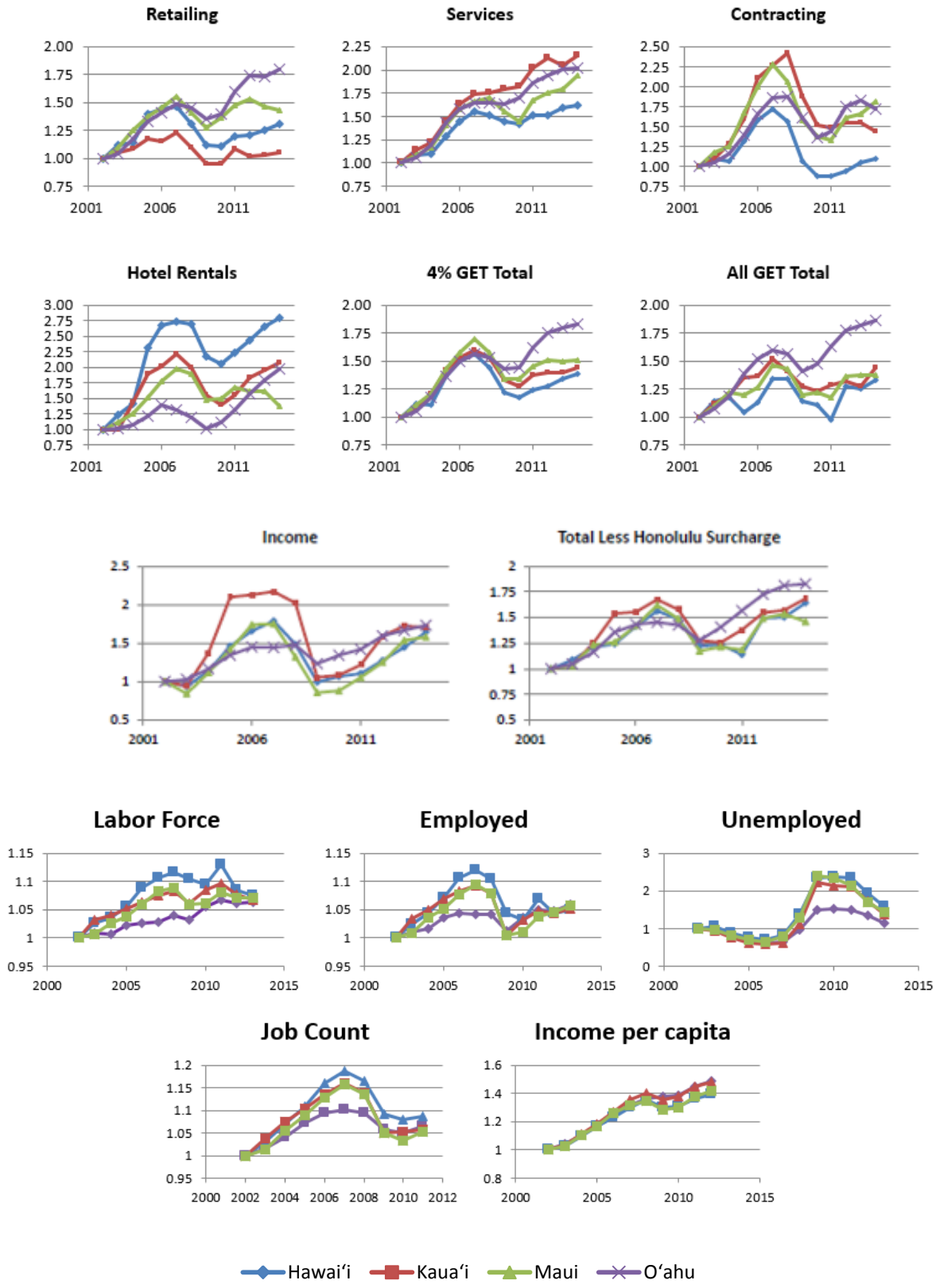
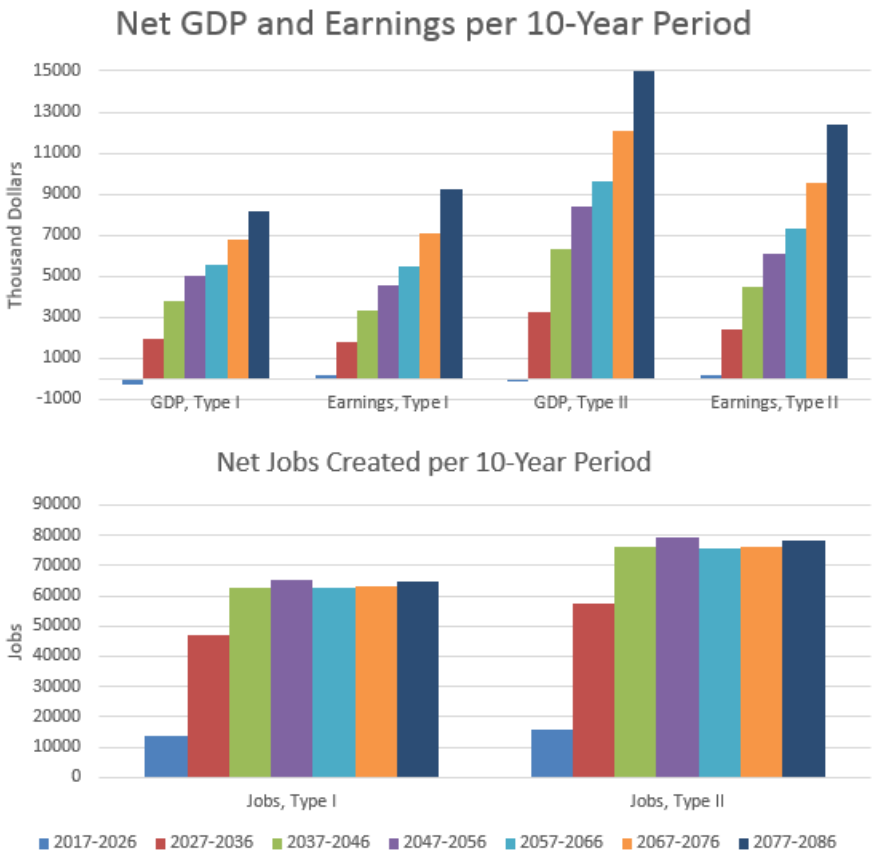

Retailing
Services
Contracting
Hotel Rentals
4% GET Total
All GET Total
Income
Total Less Honolulu Surcharge
Labor Force
Employed
Unemployed
Job Count
Income per capita
Hawai'i
Kaua'i
Maui
O'ahu

Figure 5



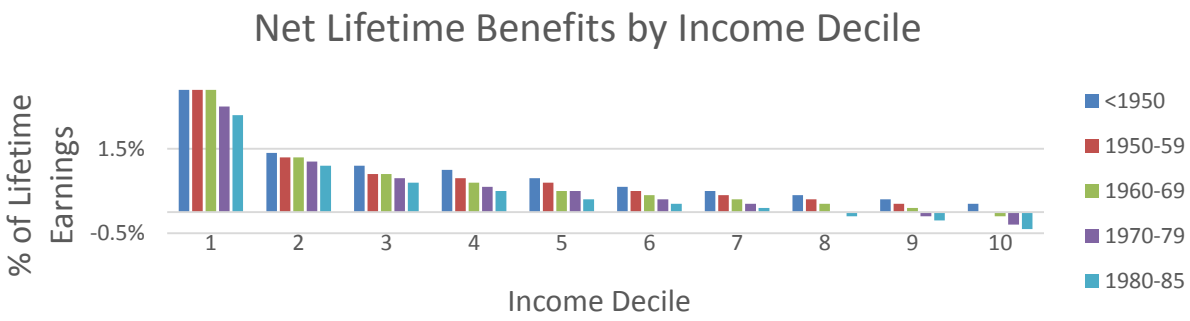
General Excise Taxes and Regressivity

One issue with the GET surcharge was brought up on multiple occasions: almost all sales tax, which the GET surcharge essentially is, are regressive – lower-income households pay a disproportionate amount of their income on sales taxes compared to higher-income households. There are two points that address this complaint: first, if the program is taken as a whole, the average lower-income household benefits significantly, since lower-income households, being in poor health, are more likely to take advantage of the benefits distributed via the program; second, the program is well-funded enough that lower-income households can get reimbursed to reduce the amount they contribute, negating the regressive nature of the GET surcharge.

There is no question that a GET surcharge tends to be more regressive than payroll and income tax. However, there are a couple things to make note of. Even though a GET surcharge tends to be more regressive than either payroll or income tax, lower income households will pay more under a payroll tax funding mechanism than under a GET surcharge funding mechanism. This is because of the difficulty in sustaining the program via a payroll tax; a payroll tax needs to be significantly higher than a GET surcharge in order to be sustainable, so lower income households pay approximately twice as much in taxes under a payroll tax funding mechanism.

Thus, despite the fact that a payroll tax is less likely to be regressive, the payroll tax will harm lower income households more than the GET surcharge. Further, if we consider the program holistically – taxes *and* benefits – then lower income households benefit more than higher income households, proportionate to income. This is due to the fact that, on average, lower income households have more health issues and are therefore more likely to make use of the benefits of the program. Figure 6 illustrates the net lifetime benefits by income decile; notice that the lower income deciles receive net lifetime benefits that are higher, as a percentage of lifetime earnings, than higher income households.

Figure 6



The issue of regressivity can be avoided altogether by providing tax credits to lower income households. Households making less than $35,000 contribute approximately 3% to the fund; households making less than $50,000 contribute approximately 6%. Reimbursing the full amount of the contributions for households earning less than $50,000 is likely to be unsustainable, and would result in a rather sharp cut-off. The alternative is to have tiered tax credits. In fact, a tiered tax credit for GET contributions already exists for income tax filers. Doing a proportional tax credit as the one that already exists, and crediting households earning less than $50,000 would use up only 1% of the fund. Thus, regressivity of the surcharge can be eliminated via tax credits, and the credits could come from fund itself. Table 1 contains estimates to the amount various reimbursements/credits for different income levels would cost the fund.

Table 1

SHARE OF GET TAX BASE

Bracket (value used for "average" calculations in parentheses)	Less than 10k (5k)	10-15k (12.5k)	15-25k (20k)	25-35k (30k)	35-50k (45k)	50-75k (65k)
Share of GET tax base	0.001821806	0.002732118	0.009180556	0.014295833	0.033155625	0.074937778
Bracket	Less than 10k	Less than 15k	Less than 25k	Less than 35k	Less than 50k	Less than 75k
Cumulative share	0.001821806	0.004553924	0.013734479	0.028030313	0.061185938	0.136123715

TAX CREDIT

Bracket (value used for "average" calculations in parentheses)	< 5k (2.5k)	5-10k (7.5k)	10-15k (12.5k)	15-20k (17.5k)	20-30k (25k)	30-40k (35k)	40-50k (45k)
Current credit per adult on N-11 ($85 per child)	85	75	65	55	45	35	25
Credit for 0.5% surcharge, proportional to current credit	10.63	9.38	8.13	6.88	5.63	4.38	3.13
Share of tax base	0.0011614	0.0010703	0.001174811	0.001566432	0.00164488	0.001779809	0.001740656
Bracket	< 5k	<10k	<15k	<20k	<30k	<40k	<50k
Cumulative share	0.0011614	0.0022317	0.003406523	0.004972955	0.00661783	0.008397642	0.010138299